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No. 16004 ✓

**United States
Court of Appeals
for the Ninth Circuit**

THE IDAHO FIRST NATIONAL BANK,
Appellant,
vs.
UNITED STATES OF AMERICA,
Appellee.

Transcript of Record

**Appeal from the United States District Court
for the District of Idaho,
Southern Division.**

FILED

JUN 12 1958

PAUL P. O'BRIEN, GLE

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

	PAGE
Answer	12
Attorneys, Names and Addresses of	1
Certificate of Clerk	33
Complaint	3
Findings of Fact and Conclusions of Law	24
Judgment	31
Notice of Appeal	32
Statement of Points Relied Upon	35
Stipulation of Fact	16

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Boise, Idaho,

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2 **THEORY OF THE CASE.**

... ..

In the District Court of the United States for the
District of Idaho, Southern Division

Civil No. 3269

THE IDAHO FIRST NATIONAL BANK,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

Plaintiff complains of defendant, and for cause of action, alleges and avers as follows to wit:

I.

During all times mentioned herein plaintiff was a duly authorized and existing corporation, under and by virtue of the National Bank Act, with its principal place of business in the City of Boise, Idaho. Plaintiff is a resident of the above-entitled judicial district.

II.

Jurisdiction herein is based upon Title 28 United States Code Sections 1346(a), 1348 and 1402(a).

III.

This is an action arising under the Internal Revenue Laws of the United States, more particularly Title 26, U.S.C.A., Section 41 (1939), Section 22 (1939), Section 6901(a)(1)(A)(1) (1954)

(prior law Section 311 (1939)), Section 6402(a) (1954) (prior law Section 322 (1939), Section 115 (c) (1939), Section 112(b)(6) (1939), Internal Revenue Income Tax Regulations 118, Sections 39.22 (a)20 and 39.115(a)2.

IV.

That prior to the 10th day of May, 1952, the Wendell National Bank, a corporation, was a duly authorized and existing corporation, under and by virtue of the National Bank Act, with its principal place of business at Wendell, Idaho, within the above-entitled judicial district.

V.

That on the 10th day of May, 1952, plaintiff purchased the entire capital stock of the Wendell National Bank, Wendell, Idaho, for the sole purpose of acquiring the assets of said bank.

VI.

That on the 10th day of May, 1952, immediately after the purchase of the Wendell National Bank stock by plaintiff, a special meeting of the stockholders of said Wendell National Bank, was held, and by resolution, duly and regularly passed by a vote of one hundred per cent of the total capital stock of said corporation the Wendell National Bank was voluntarily dissolved and E. R. Jones, Vice President of plaintiff corporation, was appointed liquidating agent, for the purpose of winding up the affairs of said corporation.

VII.

That thereafter on the 10th day of May, 1952, E. R. Jones, acting in his capacity as liquidating agent of said corporation made and executed the necessary transfers, assignment and sale of all assets and liabilities of said Wendell National Bank, both real and personal, to plaintiff in exchange for the Wendell National Bank capital stock owned by plaintiff.

VIII.

That immediately thereafter, and on the same day, said instrument was delivered to plaintiff the sole stockholder of record and conveyed to said plaintiff in kind all real estate and personal property owned by said Wendell National Bank and from and after May 10th, 1952, said Wendell National Bank owned no property either real or personal, whatsoever, and realized no income thereafter and for all intent and purposes was fully liquidated.

IX.

That said Wendell National Bank is in the general banking business and at all times prior to its ceasing business and liquidation consistently reported its income by using "cash basis" method of accounting.

X.

That on the 19th day of June, 1952, a corporation income return was filed for said Wendell National Bank, for the period from January 1st, 1952, to May 10th, 1952, by plaintiff. In said re-

turn plaintiff erroneously included as taxable income interest not due or collectible in the sum of \$10,843.55. That plaintiff did on the 19th day of June, 1952, and the 30th day of June, 1952, pay to the Collector of Internal Revenue for the District of Idaho, the corporation income tax in the amount of \$5,577.61 and \$242.51, respectively, based upon said income as reported on said tax return. Photostat copy of corporation return prepared by the office of Director of Internal Revenue is attached hereto and marked Exhibit "A."

XI.

That the interest on unmatured notes receivable were not due or demandable or collectible until the note matured, said interest being in the nature of a property right before it is due. Only a few notes were matured and delinquent. The interest was calculated at the time of liquidation in order to determine the value of the asset for liquidation purposes by computing the accrued interest on each note or bond from the date of the instrument to the date of liquidation. The amount of accrued interest was placed in pencil notation on each note. The interest was then totalled and the adding machine tape was saved and made a part of plaintiff's records.

XII.

That subsequently on or about November 18, 1954, the Commissioner of Internal Revenue through his delegate examined the final corporation income tax return of the Wendell National Bank for the period

from January 1st, 1952, to May 10, 1952. The revenue agent's report dated November 18, 1954, eliminated the erroneously accrued but not due or collectible interest in the amount of \$10,843.55, from income giving the following reason: "The Wendell National Bank has always kept records and filed returns on the cash basis. Just prior to distribution of the assets of Wendell National Bank to the Idaho First National Bank on May 10, 1952, accrued interest was set up in Wendell records and return by means of a debit to the assets receivable and credit to taxable income. Although the interest had accrued it was not payable. The accrued interest does not represent taxable income to the Wendell National Bank on cash basis of computing income and is therefore eliminated."

The elimination of interest from income in the amount of \$10,843.55, resulted in an overassessment of \$3,253.07, which was scheduled for refund on February 18, 1955, and the refund of that amount plus interest was received by plaintiff on or about March 15, 1955.

XIII.

That the examining officer correctly interpreted the law and regulations when he excluded the not due or collectible interest for the reason that "no gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may appreciated or depreciated in value since their acquisition."

XIV.

That thereafter on or about October 4, 1955, the Commissioner of Internal Revenue through his delegate re-examined the Wendell National Bank final corporation income tax return for the period from January 1st, 1952, to May 10, 1952.

XV.

That on or about October 4, 1955, the Commissioner of Internal Revenue issued the thirty day letter (bureau symbols A:R:JRC:30d:mjt) proposing to assess against plaintiff the amount of \$3,253.07, plus interest as provided by law, constituting plaintiff liability as transferee of the assets of the Wendell National Bank, Wendell, Idaho, for income taxes due for the period ended May 10, 1952. In the report attached to said thirty day letter the accrued but not due or collectible interest in the amount of \$10,843.55, was included as income and the Commissioner in his reason for including said interest as income referred to revenue ruling 255, Cumulative Bulletin 1953-2,10. He further stated "The substance of the above ruling and the cited cases is that where the taxpayer liquidating corporation has performed substantially all the services necessary to establish its right to the income, the Commissioner is within his rights under Section 41 to change the method of determining income to include such items, Section 22(a)(20) relating to the gross income of corporations in liquidation notwithstanding. In view of the foregoing, it is held that interest accrued at May 10, 1952, in the amount of

\$10,843.55, is taxable to the liquidating corporation, the Wendell National Bank and adjustment is made accordingly.”

Plaintiff did not accept the findings of the Commissioner and on December 12, 1955, filed a protest.

XVI.

That on February 3, 1956, a conference was held on said protest with a member of the Commissioner's appellate staff. No agreement was reached. However the Commissioner determined that the amount of interest in question was \$13,191.19, instead of \$10,843.55.

XVII.

That on April 6, 1956, the Commissioner of Internal Revenue issued a deficiency notice to plaintiff stating that the deficiency of \$3,957.36, plus interest as provided by law constituted the liability as transferee of assets of the Wendell National Bank, and would be assessed. Said deficiency gave plaintiff ninety days in which to file a petition with the Tax Court of the United States, at its principal address in Washington 4, D. C., for a redetermination of deficiency.

XVIII.

That plaintiff in exercising its right to choose the forum elected to pay the tax and seek relief in the United States District Court.

XIX.

That on May 25th, 1956, plaintiff paid the trans-

feree assessment of \$3,957.36 plus interest of \$896.22 or a total of \$4,853.58.

XX.

That plaintiff in paying the transferee assessment has the right to contest the tax issue of the transferor.

XXI.

That on the 29th day of May, 1956, plaintiff as transferee filed a claim for refund of \$3,957.36, plus interest provided by law. Copy of said claim is attached and made a part hereof (Exhibit "B").

XXII.

That the selection of system of keeping books is primarily for the taxpayer. That the Commissioner is not authorized to enact legislation infringing upon the free choice of accounting system which is given taxpayer under Section 41 IRC nor to arbitrarily change the accounting system used by taxpayer where it clearly reflects income. That the Wendell National Bank has for more than twenty years kept its books and reported its income on the basis of cash receipts and disbursements. That the said cash basis is an approved standard method of accounting that clearly reflects income.

That the not due or collectible interest is not income under the cash basis method of accounting. That the Commissioner does not have the authority to change this cash basis taxpayer's method of accounting in the year of liquidation where taxpayer

has consistently reported its income on the cash basis.

XXIII.

That the individual stockholders of the Wendell National Bank who sold their stock to plaintiff for \$418.50 per share paid tax as capital gain on the excess of the selling price over the cost or basis of their stock. Said excess is in fact the increment in value of the notes and other assets which were distributed to plaintiff in exchange for the Wendell National Bank stock purchased by plaintiff.

XXIV.

That plaintiff subsequently reported the interest on notes and bonds received through purchase of the Wendell National Bank as income when the interest was received, however, if offset same by the amount allocated as cost at time of liquidation.

XXV.

That the Commissioner of Internal Revenue rejected the claim for refund on the 5th, day of July, 1956. Copy is attached hereto and marked Exhibit "C."

Wherefore, plaintiff prays judgment against defendant in the sum of \$3,957.36, together with interest provided by law and their costs and disbursements herein incurred.

/s/ MYRON E. ANDERSON,
Attorney for Plaintiff.

[Endorsed]: Filed July 24, 1956.

[Title of District Court and Cause.]

ANSWER

Comes now the defendant, the United States of America, by and through its attorney Sherman F. Furey, Jr., United States Attorney in and for the District of Idaho, and for answer to the complaint of the plaintiff admits, denies and alleges as follows:

1. Admits the allegations contained in Paragraph I of the complaint.

2. Admits the allegations contained in Paragraph II of the complaint.

3. Admits the allegations of Paragraph III of the complaint, except denies that this action arises under Section 115(c) and/or Section 112(b) (6) of the Internal Revenue Code of 1939. It is further denied that this action arises under Treasury Regulations 118, Section 39.115(a)-2.

4. Admits the allegations contained in Paragraph IV of the complaint.

5. Admits the allegations contained in Paragraph V of the complaint.

6. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph VI of the complaint.

7. Alleges that it is without knowledge or information sufficient to form a belief as to the truth

of the allegations contained in Paragraph VII of the complaint, except admits that on May 10, 1952, all assets and liabilities of the Wendell National Bank, both real and personal, were delivered to the plaintiff in exchange for the Wendell National Bank capital stock owned by the plaintiff.

8. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph VIII of the complaint, except admits that on May 10, 1952, all the real estate and personal property owned by the Wendell National Bank was conveyed in kind to the plaintiff.

9. Denies the allegations contained in Paragraph IX of the complaint, except admits that the Wendell National Bank was in the general banking business prior to May 10, 1952.

10. Denies the allegations contained in Paragraph X of the complaint, except admits that on June 20, 1952, a corporation income tax return was filed for the Wendell National Bank for the period from January 1, 1952, to May 10, 1952. It is further admitted that the Wendell National Bank reported as taxable income in that return accrued interest in the amount of \$10,843.55. It is further admitted that the plaintiff paid \$5,577.61 on June 25, 1952, and on July 7, 1952, plaintiff paid \$242.51 to the defendant in satisfaction of the tax liability interest in the amount of \$10,843.55. It is further admitted that the income tax return for the Wendell National Bank for the period January 1, 1952, to

May 10, 1952, is attached to the complaint and marked Exhibit "A."

11. Denies the allegations contained in Paragraph XI of the complaint, except alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in the last three sentences of Paragraph XI.

12. Admits the allegations contained in Paragraph XII of the complaint, except denies that on the income tax return filed for the Wendell National Bank January 1, 1952, to May 10, 1952, there was any interest erroneously accrued, which was not due or collectible. It is further denied that there was ever any over-assessment of income taxes against the Wendell National Bank. The defendant alleges that \$3,253.07 which was scheduled for refund to the plaintiff on February 17, 1955, was refunded to the plaintiff on that date.

13. Denies the allegations contained in Paragraph XIII of the complaint.

14. Admits the allegations contained in Paragraph XIV of the complaint.

15. Admits the allegations contained in Paragraph XV of the complaint, except denies that interest in the amount of \$10,843.55 was not due or collectable.

16. Admits the allegations contained in Paragraph XVI of the complaint.

17. Admits the allegations contained in Paragraph XVII of the complaint.

18. Admits the allegations contained in Paragraph XVIII of the complaint.

19. Admits the allegations contained in Paragraph XIX of the complaint, except alleges that the payment referred to in Paragraph XIX of the complaint was made by the plaintiff on May 29, 1956.

20. Admits the allegations contained in Paragraph XX of the complaint.

21. Denies the allegations contained in Paragraph XXI of the complaint, except admits that on May 29, 1956, the plaintiff as transferee of the assets of the Wendell National Bank filed a claim for refund of \$3,957.36, or any other amount legally refundable. It is further admitted that a copy of that claim is attached to the complaint and denominated Exhibit "B."

22. For answer to Paragraph XXII of the complaint the defendant alleges that the allegations contained therein, with the exception of the allegations contained in the third sentence of Paragraph XXII, constitute conclusions of law and as such require no answer. However, if it is determined that any or all of these allegations require an answer the defendant denies each and every one of them. The defendant further alleges that it is without knowledge or information sufficient to form a belief as to

the truth of the allegations contained in the third sentence of Paragraph XXII of the complaint.

23. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph XXIII of the complaint.

24. Alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph XXIV of the complaint.

25. Admits the allegations contained in Paragraph XXV of the complaint.

Wherefore, having fully answered, the defendant prays for judgment in its favor, for dismissal of the plaintiff's complaint, and for the costs of this action.

SHERMAN F. FUREY, JR.,
United States Attorney;

By /s/ MARION J. CALLISTEN,
Assistant U. S. Attorney.

[Endorsed]: Filed September 21, 1956.

[Title of District Court and Cause.]

STIPULATIONS OF FACT

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel of record, that the following facts shall be taken as

true without prejudice to the right of either party to furnish material and competent evidence of any other facts not inconsistent herewith or to object to the introduction in evidence of such facts on the grounds of immateriality or irrelevancy.

1. During all times mentioned herein plaintiff was a duly authorized and existing corporation, under and by virtue of the National Bank Act, with its principal place of business in the City of Boise, Idaho. Plaintiff is a resident of the above-entitled judicial district.

2. The court has jurisdiction over this action by virtue of 28 U.S.C., Sections 1346(a), 1348 and 1402(a).

3. Prior to the 10th day of May, 1952, the Wendell National Bank, a corporation, was a duly authorized and existing corporation, under and by virtue of the National Bank Act, with its principal place of business at Wendell, Idaho, within the above-entitled judicial district.

4. On the 10th day of May, 1952, plaintiff purchased the entire capital stock of the Wendell National Bank, Wendell, Idaho, for the sole purpose of acquiring the assets of said bank.

5. On the 10th day of May, 1952, immediately after the purchase of the Wendell National Bank stock by plaintiff, a special meeting of the stockholders of said Wendell National Bank was held, and by resolution, duly and regularly passed by a vote of one hundred per cent of the total capital

stock of said corporation, the Wendell National Bank was voluntarily dissolved and E. R. Jones, Vice-President of plaintiff corporation, was appointed liquidating agent, for the purpose of winding up the affairs of said corporation. A copy of the resolution of the stockholders of the Wendell National Bank voluntarily dissolving the said corporation and the appointment of E. R. Jones, Vice-President, as liquidating agent is attached as Exhibit A.

6 On May 10, 1952, all assets and liabilities of the Wendell National Bank, both real and personal, were delivered to plaintiff in accordance with the terms of Exhibit A to this stipulation.

7. On May 10, 1952, the Wendell National Bank was fully liquidated for all intents and purposes.

8. Said Wendell National Bank was in the general banking business and prior to its ceasing business and liquidating consistently reported its income on the "cash basis" method of accounting. A copy of affidavit from Virginia Dodge, C. P. A., an employee of the plaintiff is attached hereto as Exhibit B, to this stipulation.

9. On June 20, 1952, a corporation income tax return was filed for the Wendell National Bank, for the period from January 1, 1952, through May 10, 1952, by plaintiff. In that return the plaintiff included as taxable income accrued interest on notes receivable in the amount of \$10,843.55. Plaintiff paid \$5,577.61, on June 25, 1952, and on July 7,

1952, the plaintiff paid \$242.51, to the defendant in satisfaction of the tax liability shown to be due on that return. A photocopy of the income tax return for the Wendell National Bank for the period January 1, 1952, to May 10, 1952, is attached as Exhibit C, to this stipulation.

10. The accrued interest on notes receivable was calculated at the time of liquidation of the Wendell National Bank in order to determine the value of the assets for liquidation purposes by computing the interest earned but not then payable, on each note from the date of the instrument to the date of the liquidation. The amount of the accrued interest was placed in pencil notation on each note. The interest was then totaled by means of an adding machine tape, the total being \$13,191.19. Expenses attributable to this accrued interest on notes receivable had been deducted for income tax purposes when paid by the Wendell National Bank prior to its liquidation. Unpaid accrued expenses of the Wendell National Bank had not been deducted for income tax purposes at the date of liquidation.

11. Subsequently on or about November 18, 1954, the Commissioner of Internal Revenue through his delegate examined the final corporation income tax return of the Wendell National Bank for the period from January 1, 1952, to May 10, 1952. The revenue agent's report dated November 18, 1954, eliminated the accrued interest from income giving the following reason: "The Wendell National Bank has always kept records and filed returns on the cash

basis. Just prior to the distribution of the assets of the Wendell National Bank to the Idaho First National Bank on May 10, 1952, accrued interest was set up in Wendell record and return by means of a debit to the assets receivable and credit to taxable income. Although the interest had accrued it was not payable. The accrued interest does not represent taxable income to the Wendell National Bank on cash basis of computing income and is therefore eliminated."

12. The Internal Revenue Service determined that the elimination from income of accrued interest on notes receivable in the amount of \$10,843.55, resulted in an overassessment in the amount of \$3,253.07, which was scheduled for refund on February 17, 1955. The refund of that amount plus interest was received by the plaintiff on or about March 15, 1955.

13. Thereafter and prior to October 4, 1955, the Commissioner of Internal Revenue through his delegate re-examined the Wendell National Bank final corporation income tax return for the period from January 1, 1952, to May 10, 1952.

14. On October 4, 1955, the Commissioner of Internal Revenue issued the thirty day letter (Bureau Symbols A:R:JRC:30d:mjt) proposing to assess against plaintiff the amount of \$3,253.07, plus interest as provided by law, constituting the plaintiff's liability as a transferee of the assets of the Wendell National Bank, Wendell, Idaho, for income

taxes due for the period ended May 10, 1952. In the report attached to that thirty day letter the accrued interest on notes receivable in the amount of \$10,843.55, was included as taxable income of the Wendell National Bank and the Commissioner of Internal Revenue in his reason for including that interest as income referred to revenue ruling 255, Cumulative Bulletin 1953-2, 10. He further stated that, "The substance of the above ruling and the cited cases is that where the taxpayer liquidating corporation has performed substantially all the services necessary to establish its right to the income, the Commissioner is within his rights under Section 41 to change the method of determining income to include such items, Section 22(a)(20) relating to the gross income of corporations in liquidation notwithstanding. In view of the foregoing, it is held that interest accrued at May 10, 1952, in the amount of \$10,843.55, is taxable to the liquidating corporation, the Wendell National Bank, and adjustment is made accordingly."

Plaintiff did not accept the findings of the Commissioner and on December 12, 1955, filed a protest.

15. On February 3, 1956, a conference was held on the protest with a member of the appellate staff of the Internal Revenue Service. No agreement was reached. However, the Commissioner correctly determined that the amount of accrued interest in question was \$13,191.19, instead of \$10,843.55.

16. On April 6, 1956, the Commissioner of Internal Revenue issued a deficiency notice to the

plaintiff stating that the deficiency of \$3,957.36, plus interest as provided by law constituted its liability as a transferee of the assets of the Wendell National Bank, and would be assessed unless the plaintiff filed a petition in the Tax Court of the United States, within ninety days, seeking a redetermination of the deficiency.

17. Plaintiff in exercising its right to choose the forum elected to pay the tax and seek relief in the United States District Court.

18. On May 29, 1956, plaintiff paid the transferee assessment of \$3,957.36, plus interest of \$896.22 or a total of \$4,853.58.

19. The plaintiff in paying the transferee assessment has the right to contest the tax issue of the transferor and is liable as transferee for any additional tax owed by the transferor.

20. On May 29, 1956, the plaintiff as transferee, filed a claim for refund of \$3,957.36, or any other amount legally refundable by law, plus interest provided by law. A copy of that claim for refund is attached as Exhibit D to this stipulation.

21. The Wendell National Bank has always kept its records and filed its Federal income tax returns on the cash basis of accounting.

22. At the time it acquired the net assets of the Wendell National Bank, the plaintiff allocated \$10,-843.55, of the purchase price of the assets to accrued interest on notes receivable. In a subsequent revenue agents' examination of the Idaho First National

Bank, the amount of accrued interest on notes receivable was corrected to \$13,191.19. When this accrued interest was collected by the plaintiff subsequent to its purchase of the assets of the Wendell National Bank it reported it as income for tax purposes but offset the collections against the allocated cost of the accrued interest on notes receivable, so that all of the amount collected was recovery of cost and not subject to income tax.

23. The individual stockholders of the Wendell National Bank who sold their stock to plaintiff for \$418.50 per share paid a capital gains tax on the excess of the selling price over the cost or other basis of their stock. A copy of the Federal tax return of Austin and Eda Schouweiler, principal stockholders, is attached hereto as Exhibit E, to this stipulation.

24. That the Commissioner of Internal Revenue rejected the claim for refund on the 5th day of July, 1956. Copy of said rejection notice is attached as Exhibit F, to this stipulation.

/s/ MYRON E. ANDERSON,
Attorney for Plaintiff.

/s/ BEN PETERSON,
Attorney for the Defendant.

[Endorsed]: Filed August 14, 1957.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case coming on to be heard on completely stipulated facts, and the Court having considered the stipulation of facts, the exhibits thereto and the briefs of both parties filed herein, and having heretofore, on October 4, 1957, entered its Memorandum of Decision in favor of the defendant, and the Court being otherwise fully advised in the premises, does hereby make and enter its findings of fact and conclusions of law.

Findings of Fact

1. During all times mentioned herein plaintiff was a duly authorized and existing corporation, under and by virtue of the National Bank Act, with its principal place of business in the City of Boise, Idaho. Plaintiff is a resident of the above-entitled judicial district.

2. Prior to the 10th day of May, 1952, the Wendell National Bank, a corporation, was a duly authorized and existing corporation, under and by virtue of the National Bank Act, with its principal place of business at Wendell, Idaho, within the above-entitled judicial district.

3. On the 10th day of May, 1952, plaintiff purchased the entire capital stock of the Wendell National Bank, Wendell, Idaho, for the sole purpose of acquiring the assets of said bank.

4. On the 10th day of May, 1952, immediately after the purchase of the Wendell National Bank stock by plaintiff, a special meeting of the stockholders of said Wendell National Bank was held, and by resolution, duly and regularly passed by a vote of one hundred per cent of the total capital stock of said corporation, the Wendell National Bank was voluntarily dissolved and E. R. Jones, Vice-President of plaintiff corporation, was appointed liquidating agent, for the purpose of winding up the affairs of said corporation.

5. On May 10, 1952, all assets and liabilities of the Wendell National Bank, both real and personal, were delivered to plaintiff.

6. On May 10, 1952, the Wendell National Bank was fully liquidated for all intents and purposes.

7. Said Wendell National Bank was in the general banking business and prior to its ceasing business and liquidating consistently reported its income on the "cash basis" method of accounting.

8. On June 20, 1952, a corporation income tax return was filed for the Wendell National Bank, for the period from January 1, 1952, through May 10, 1952, by plaintiff. In that return the plaintiff included as taxable income accrued interest on notes receivable in the amount of \$10,843.55. Plaintiff paid \$5,577.61 on June 25, 1952, and on July 7, 1952, the plaintiff paid \$242.51 to the defendant in satisfaction of the tax liability shown to be due on that return.

9. The accrued interest on notes receivable was calculated at the time of liquidation of the Wendell National Bank in order to determine the value of the assets for liquidation purposes by computing the interest earned but not then payable, on each note from the date of the instrument to the date of the liquidation. The amount of the accrued interest was placed in pencil notation on each note. The interest was then totaled by means of an adding machine tape, the total being \$13,191.19. Expenses attributable to this accrued interest on notes receivable had been deducted for income tax purposes when paid by the Wendell National Bank prior to its liquidation. Unpaid accrued expenses of the Wendell National Bank had not been deducted for income tax purposes at the date of liquidation.

10. Subsequently on or about November 18, 1954, the Commissioner of Internal Revenue through his delegate examined the final corporation income tax return of the Wendell National Bank for the period from January 1, 1952, to May 10, 1952. The revenue agent's report dated November 18, 1954, eliminated the accrued interest from income giving the following reason: "The Wendell National Bank has always kept records and filed returns on the cash basis. Just prior to the distribution of the assets of the Wendell National Bank to the Idaho First National Bank on May 10, 1952, accrued interest was set up in Wendell record and return by means of a debit to the assets receivable and credit to taxable income. Although the interest had accrued it was not pay-

able. The accrued interest does not represent taxable income to the Wendell National Bank on cash basis of computing income and is therefore eliminated.”

11. The Internal Revenue Service determined that the elimination from income of accrued interest on notes receivable in the amount of \$10,843.55 resulted in an overassessment in the amount of \$3,253.07, which was scheduled for refund on February 17, 1955. The refund of that amount plus interest was received by the plaintiff on or about March 15, 1955.

12. Thereafter and prior to October 4, 1955, the Commissioner of Internal Revenue through his delegate re-examined the Wendell National Bank final corporation income tax return for the period from January 1, 1952, to May 10, 1952.

13. On October 4, 1955, the Commissioner of Internal Revenue issued the thirty-day letter (Bureau Symbols A:R:JRC:30d:mjt) proposing to assess against plaintiff the amount of \$3,253.07, plus interest as provided by law, constituting the plaintiff's liability as a transferee of the assets of the Wendell National Bank, Wendell, Idaho, for income taxes due for the period ended May 10, 1952. In the report attached to that thirty-day letter the accrued interest on notes receivable in the amount of \$10,843.55, was included as taxable income of the Wendell National Bank and the Commissioner of Internal Revenue in his reason for including that interest as income referred to revenue ruling 255,

Cumulative Bulletin 1953-2, 10. He further stated that "The substance of the above ruling and the cited cases is that where the taxpayer liquidating corporation has performed substantially all the services necessary to establish its right to the income, the Commissioner is within his rights under Section 41 to change the method of determining income to include such items, Section 22 (a) (20) relating to the gross income of corporations in liquidation notwithstanding. In view of the foregoing, it is held that interest accrued at May 10, 1952, in the amount of \$10,843.55, is taxable to the liquidating corporation, the Wendell National Bank, and adjustment is made accordingly."

Plaintiff did not accept the findings of the Commissioner and on December 12, 1955, filed a protest.

14. On February 3, 1956, a conference was held on the protest with a member of the appellate staff of the Internal Revenue Service. No agreement was reached. However, the Commissioner correctly determined that the amount of accrued interest in question was \$13,191.19, instead of \$10,843.55.

15. On April 6, 1956, the Commissioner of Internal Revenue issued a deficiency notice to the plaintiff stating that the deficiency of \$3,957.36, plus interest as provided by law constituted its liability as a transferee of the assets of the Wendell National Bank, and would be assessed unless the plain-

tiff filed a petition in the Tax Court of the United States, within ninety days, seeking a redetermination of the deficiency.

16. Plaintiff in exercising its right to choose the forum elected to pay the tax and seek relief in the United States District Court.

17. On May 29, 1956, plaintiff paid the transferee assessment of \$3,957.36, plus interest of \$896.22 or a total of \$4,853.58.

18. The plaintiff in paying the transferee assessment has the right to contest the tax issue of the transferor and is liable as transferee for any additional tax owed by the transferor.

19. On May 29, 1956, the plaintiff as transferee, filed a claim for refund of \$3,957.36, or any other amount legally refundable by law, plus interest provided by law.

20. The Wendell National Bank has always kept its records and filed its federal income tax returns on the cash basis of accounting.

21. At the time it acquired the net assets of the Wendell National Bank, the plaintiff allocated \$10,-843.55 of the purchase price of the assets to accrued interest on notes receivable. In a subsequent revenue agent's examination of the Idaho First National Bank, the amount of accrued interest on notes receivable was corrected to \$13,191.19. When this accrued interest was collected by the plaintiff subsequent to its purchase of the assets of the Wendell

National Bank it reported it as income for tax purposes but offset the collections against the allocated cost of the accrued interest on notes receivable, so that all of the amount collected was recovery of cost and not subject to income tax.

22. The individual stockholders of the Wendell National Bank who sold their stock to plaintiff for \$418.50 per share paid a capital gains tax on the excess of the selling price over the cost or other basis of their stock.

23. The Commissioner of Internal Revenue rejected the claim for refund on the 5th day of July, 1956.

Conclusions of Law

1. The court has jurisdiction over this case by virtue of 28 U.S.C. Section 1346 (a) (1).

2. The position taken by the defendant in this case is warranted by statute and has ample support in the decisions.

3. Accordingly the interest accrued on notes receivable in the taxable period ending with the liquidation of the Wendell National Bank are taxable as income to it in that year, notwithstanding the fact that it reported its income for tax purposes on the cash receipts and disbursements basis.

4. Judgment will be entered in favor of the defendant, dismissing the plaintiff's complaint, with costs to be paid by the plaintiff.

Dated this 2nd day of December, 1957.

/s/ WILLIAM HEALY,

Acting United States District
Judge.

[Endorsed]: Filed December 2, 1957.

In the United States District Court for the
District of Idaho, Southern Division

Civil Action No. 3269

THE IDAHO FIRST NATIONAL BANK,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

The above-entitled cause having been submitted on an agreed statement of facts and stipulation, and the court having fully considered the pleadings, the agreed statement of facts and stipulation, and the briefs of the parties on file herein, and being fully advised and after deliberating in the premises, and having filed herein its findings of fact and conclusions of law and having heretofore denied plaintiff's motion for amendment of said findings of fact and conclusions of law, and having directed

that judgment be entered in accordance with the findings of fact and conclusions of law and having heretofore denied plaintiff's motion for amendment of said findings of fact and conclusions of law, and having directed that judgment be entered in accordance with the findings of fact and conclusions of law heretofore entered, now, therefore, by reason of the law and the findings aforesaid, it is hereby

Ordered, Adjudged, and Decreed that defendant, United States of America, do have and is awarded judgment against the plaintiff, the Idaho First National Bank, and that said defendant do have and recover of and from said plaintiff its costs in this action.

Dated this 24th day of January, 1958.

/s/ WILLIAM HEALY,
Acting District Judge.

[Endorsed]: Filed January 27, 1958.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that The Idaho First National Bank, plaintiff above named, hereby appeals to the United States Court of Appeals for the Ninth

Circuit from the final judgment dated January 24, 1958, entered in this action on January 27, 1958.

/s/ MYRON E. ANDERSON,

ANDERSON, KAUFMAN
AND ANDERSON,

By /s/ EUGENE H. ANDERSON,
Attorneys for Plaintiff.

[Endorsed]: Filed March 19, 1958.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
District of Idaho—ss.

I, Ed. M. Bryan, Clerk of the United States District Court for the District of Idaho, do hereby certify that the foregoing papers are that portion of the original files designated by the parties and as are necessary to the appeal under Rule 75(RCP):

1. Complaint.
2. Answer.
3. Stipulation of Fact with Exhibits A, B, C, D, E and F attached.
4. Minutes of the Court of August 14, 1957.
5. Memorandum of Decision dated October 4, 1957.
6. Findings of Fact and Conclusions of Law.
7. Judgment.

8. Notice of appeal.
9. Statement of points.
10. Designation of appellant of contents of record on appeal.
11. Designation of appellee of additional portions of record on appeal.
12. Copy of docket entries.

In Witness Whereof I have hereunto set my hand and affixed the seal of said court, this 21st day of April, 1958.

[Seal]

ED. M. BRYAN,
Clerk;

By /s/ LONA MANSER,
Deputy.

[Endorsed]: No. 16004. United States Court of Appeals for the Ninth Circuit. The Idaho First National Bank, Appellant, vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Idaho, Southern Division.

Filed: April 24, 1958.

Docketed: May 5, 1958.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16004

THE IDAHO FIRST NATIONAL BANK,

Appellant,

vs.

UNITED STATES OF AMERICA,

Respondent.

STATEMENT OF POINTS RELIED UPON

Pursuant to Rule 17, subsection 6, of the above-entitled Court, appellant makes Statement of Points as follows:

I.

Interest neither due nor payable, on notes and obligations to a banking corporation reporting its income for tax purposes on a cash basis, is not taxable income to the banking corporation upon its liquidation and the transfer of its assets to its shareholder.

Dated May 2nd, 1958.

/s/ MYRON E. ANDERSON,
ANDERSON, KAUFMAN
AND ANDERSON,

By /s/ EUGENE H. ANDERSON,
Attorneys for Appellant.

[Endorsed]: Filed May 5, 1958.

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No. 16,004

United States Court of Appeals
For the Ninth Circuit

IDAHO FIRST NATIONAL BANK,
Appellant,

VS.

UNITED STATES OF AMERICA,
Appellee.

Appeal from the United States District Court
for the District of Idaho,
Southern Division.

BRIEF OF APPELLANT.

MILTON E. ANDERSON,
Idaho Building, Boise, Idaho,
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EUGENE H. ANDERSON,
Idaho Building, Boise, Idaho,
Attorneys for Appellant.

FILED

JUL 29 1958

PAUL P. O'BRIEN, CLERK

INDEX

	Page
Statutes and regulations	1
Statement of pleadings and facts disclosing basis of jurisdiction	4
Statement of the case	5
Question presented	8
Specifications of error	9
Argument	9
Relative rights of taxpayer and Commissioner on accounting method and definitions	9
Changes by Commissioner	11
Distribution by corporation on dissolution	12

Table of Cases

	Pages
Cecil v. Commissioner of Internal Revenue, 100 F. 2d 896, 902	11
Glenn v. Kentucky Color & Chemical Co., Inc., 186 F. 2d 975	10
Herbert v. Riddell, 103 F. Supp. 369	13
Hess Co., Henry, Commissioner v., 210 F. 2d 553	13
Horschel, U. S. v., 205 F. 2d 646	13
Huntington Securities Corporation v. Busey, 112 F. 2d 368	10
Martinus & Sons, J. H. v. Commissioner of Internal Revenue, 116 F. 2d 732	11
Mitchell, et al., U. S. v., 46 S. Ct. 419, 271 U. S. 9, 70 L. Ed. 799	11
Osterloh v. Lucas, 37 F. 2d 277	11
Telephone Directory Advertising Company, et al v. U. S., 142 F. Supp. 884	13
Welch v. DeBlois, et al, 94 F. 2d 842	10
Wolf Bakery and Cafeteria Co., T. C. Memo, P.-H. 46, 117 (Docket No. 7899; 5-23-46)	10

Codes

26 U.S.C.A. (Internal Revenue Code (1939)) :	
Sec. 22	1
Sec. 29.22(a)20	3, 6
Sec. 29.41-1	3
Sec. 29.41-2	2
Sec. 29.41-3	2
Sec. 29.52-1	3
Sec. 29.115-3	4
Sec. 41	2, 6, 10
Secs. 42 and 43	2
Sec. 48	2
28 United States Code, Secs. 1346(a), 1348 and 1402(a)	4

United States Court of Appeals For the Ninth Circuit

THE IDAHO FIRST NATIONAL BANK,	}
<i>Appellant,</i>	
VS.	
UNITED STATES OF AMERICA,	
<i>Appellee.</i>	

Appeal from the United States District Court
for the District of Idaho,
Southern Division.

BRIEF OF APPELLANT.

STATUTES AND REGULATIONS.

26 U.S.C.A.: (Internal Revenue Code (1939))

Sec. 22. Gross Income.

(a) General Definition — Gross income includes gains, profits, . . . interest . . .

Sec. 41. (Accounting Period and Methods). General Rule. The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the

Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in Section 48, or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

Treasury Regulations 111:

Sec. 29.41-2. Bases of Computation and Changes in Accounting Methods. Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48, for definitions of "paid or accrued" and "paid or incurred". All items of gross income shall be included in gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. But see sections 42 and 43. See also section 48 . . . A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See sections 29.42-2 and 29.42-3). On the other hand appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property . . .

Sec. 29.41-3. Methods of Accounting. It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law

contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so . . .

Sec. 29.41-1. **Computation of Net Income.** Net income must be computed with respect to a fixed period . . . If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for . . .

Sec. 29.52-1. **Corporation Returns.** Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income . . . A corporation having an existence during any portion of a taxable year is required to make a return. If a corporation was not in existence throughout an annual accounting period (either calendar year or fiscal year), the corporation is required to make a return for that fractional part of the year during which it was in existence. A corporation is not in existence after it ceases business and dissolves, retaining no assets, whether or not under state law it may thereafter be treated as continuing as a corporation for certain limited purposes connected with winding up of its affairs such as for the purpose of suing and being sued . . .

Sec. 29.22(a)20. **Gross Income of a Corporation in Liquidation.** When a corporation is dissolved . . . No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation,

however they may have appreciated or depreciated in value since their acquisition . . .

Sec. 29.115-3. Earnings or Profits. In determining the amounts of earnings or profits . . . due consideration must be given to the facts, . . . the amount of earnings or profits in any case will be dependent upon the method of accounting properly employed in computing net income. For instance, a corporation keeping its books and filing its income tax returns under sections 41, 42 and 43 on the cash receipts and disbursements basis may not use the accrual basis in determining earnings and profits; . . .

STATEMENT OF PLEADINGS AND FACTS DISCLOSING BASIS OF JURISDICTION.

Complaint was filed by The Idaho First National Bank, appellant, against the United States, respondent, in the District Court of the United States for the District of Idaho, Southern Division, for the recovery of income taxes theretofore paid. Jurisdiction was based upon Title 28 United States Code, Secs. 1346(a), 1348 and 1402(a). (Tr. pages 3 to 11.) The cause was placed at issue by Answer of the United States. (Tr. pages 12 to 16.) The cause was tried and submitted for decision on Stipulations of Fact, the Hon. William Healy, acting District Judge, presiding. (Tr. pages 16 to 23.) Findings of Fact and Conclusions of Law, and Judgment based thereon, in favor of respondent, the United States, were made and entered in the lower court. (Tr. pages 24 to 32.) The Idaho First National Bank, plaintiff below and appellant here, appealed to this court from the Judgment.

STATEMENT OF THE CASE.

Wendell National Bank, a corporation with its banking house at Wendell, Idaho, operated for many years. On May 10, 1952 appellant Idaho First National Bank purchased from the stockholders of Wendell National Bank the entire capital stock of the latter corporation. The purchase was for the sole purpose of acquiring the assets of the Wendell bank.

Immediately thereafter and on the same day as the purchase of the stock, Wendell bank was voluntarily dissolved and all of its assets and liabilities distributed to appellant.

Included in the assets were the notes evidencing the outstanding loans of the Wendell bank which were not due nor payable. The notes bore interest which was not due nor payable.

The Wendell bank had consistently reported its net income for tax purposes on the cash basis method of accounting. Its cash basis method covered both its gross income and its deductions. It reported on a calendar year basis.

However, the appellant, as transferee of the assets, caused income tax return to be filed for the Wendell bank for the period January 1, 1952 through May 10, 1952, reporting as income the amount of the interest on the notes computed to the time of dissolution and distribution, although such interest was neither due nor payable, and the notes unmatured. The unpaid expenses and deductible items, however, were not computed nor used as a deduction against income in the tax return.

Subsequently, examination of such tax return was made by the Internal Revenue Service, which, upon such examination, eliminated such interest from income of the Wendell bank, on the ground that such interest was not taxable income to the Wendell bank for the reason that it was a cash basis taxpayer. The portion of the tax attributable to the interest was refunded to the appellant.

Thereafter, the Internal Revenue Service re-examined the tax return of the Wendell bank, and reversed its decision, and included such interest in income in the period covered by the tax return. Its reason appearing in the Stipulations of Fact, Section 13 (Tr. pages 27 and 28) is quoted as follows:

“The substance of the above ruling and the cited cases is that where the taxpayer liquidating corporation has performed substantially all the services necessary to establish its right to the income, the Commissioner is within his rights under Section 41 to change the method of determining income to include such items, Section 22 (a) (20) relating to the gross income of corporation in liquidation notwithstanding.”

It appears obvious that the reference to “Section 22(a)(20)” is in error. The Commissioner must have intended to refer to Regulation 111, Sec. 29.22(a)-20. The Section 41 referred to is obviously Section 41 of the 1939 Internal Revenue Code. (Title 26 USCA Sec. 41) (1939).

The appellant as transferee of the assets, paid the tax assessed, filed application for refund which was denied, and instituted this action.

The amount of the interest involved was finally determined to be \$13,191.19 and the amount of tax involved \$3,957.36 plus interest.

The calculation and computation by the Commissioner included in income only the interest, which interest was neither due nor payable at the date of dissolution. No calculation, computation, or other consideration, was given to any of the unpaid expenses or deductions of Wendell Bank, attributable to the period covered by the tax return.

It is the position of appellant that:

A taxpayer may compute its income, and make its income tax returns, on a cash basis; the selection of the cash basis system is lodged exclusively in the taxpayer provided it is within the statutory limits of clearly reflecting income for tax purposes and such method must be consistent from year to year; if the taxpayer's method of accounting clearly reflects income, statute is mandatory on both taxpayer and Commissioner that taxable income be determined in accordance therewith;

That the word "clearly" within the statute permitting taxpayer to make its income tax return on cash basis in accordance with method of accounting regularly employed in keeping its books, means plainly, honestly, straightforwardly and frankly;

That the word "method" within the statute permitting taxpayer to make income tax return on a cash basis means the way of keeping the taxpayer's books according to a defined and regular plan; and, only where the "method" (being a way of keeping

taxpayer's books according to a defined and regular plan) does not clearly reflect income, can the Commissioner change the method.

It is further the position of appellant that the decision of the Commissioner is not actually a change of method.

It is the further position of appellant that:

The distribution to shareholders of accrued items of income, in the process of dissolution and distribution of a cash basis corporate taxpayer, is not an assignment of anticipatory income;

That where the shareholders of a fully dissolved corporation receive money or other property which would have been taxable income to the corporation at the time, if the corporation were still in existence, the corporation is not taxable thereon; and,

That upon liquidation and distribution of the assets of a corporation, to the shareholder, income derived from the property is taxable to the recipient of the distributed share, and not to the corporation.

QUESTION PRESENTED.

Where a banking corporation has consistently reported its income and deductions for income tax purposes, including its interest income, on a cash receipts and disbursements method of accounting, can the Commissioner, in the year of its liquidation, include in income, interest which was neither due nor payable on unmatured notes, in order to make such interest taxable income to such banking corporation in the tax period ending with its liquidation.

SPECIFICATIONS OF ERROR.

The court erred in its concluding as a matter of law (Tr. page 30), that the position taken by the respondent in this case is warranted by statute and has ample support in the decisions.

The court erred in concluding as a matter of law (Tr. page 30) that the interest on notes receivable, which interest was neither due nor payable, in the taxable period ending with the liquidation of the Wendell bank, is taxable as income to it in that period, notwithstanding the fact that it reported its income for tax purposes on the cash receipts and disbursements basis.

The court erred as a matter of law in concluding (Tr. page 30) that judgment be entered in favor of defendant and dismissing plaintiff's complaint.

ARGUMENT.

RELATIVE RIGHTS OF TAXPAYER AND COMMISSIONER ON ACCOUNTING METHOD AND DEFINITIONS.

The Wendell bank, for many years, consistently reported its income for tax purposes on a cash receipts and disbursements method of accounting. Its right to do so is well founded in the Internal Revenue Acts, Regulations and Decisions.

Selection of this basis or system of accounting was lodged exclusively with the Wendell bank, with only one proviso, namely, that such method clearly reflect income for tax purposes and that such method be consistent from year to year. If such method clearly

reflects income, then the statute, (Sec. 41 of the Internal Revenue Code) (Tit. 26, 1948 Edition, USCA, Sec. 41; Tit. 26 U.S.C.A. Int. Rev. Code 1939 as amended, Sec. 41) is mandatory on both the taxpayer and Commissioner that the taxable income be determined in accordance therewith.

Huntington Securities Corp. v. Busey, 112 F. 2d 368;

Glenn v. Kentucky Color etc., 186 F. 2d 975.

The courts have defined the word "clearly" as used in the statute to mean plainly, honestly, straightforwardly and frankly. The courts have distinguished between the words "clearly" and "accurately", stating that the cash receipts and disbursements method of accounting frequently does not accurately reflect earned or partially earned income or incurred or partially incurred expense. The courts have defined the word "accurately" in the ordinary use of the term to mean precisely, exactly, correctly and without error or defect and have distinguished such expressions from the word "clearly" as used in the statute.

Huntington Securities Corp. v. Busey, 112 F. 2d 368;

Welch v. DeBlois, 94 F. 2d 842;

Wolf Bakery and Cafeteria Co., T. C. Memo, P.-H. 46,117, (Docket No. 7899; 5-23-46).

The courts have defined the word "method" as used in the statute as being according to a way of keeping the taxpayer's records according to a defined and regular plan.

Huntington Securities Corp. v. Busey, 112 F. 2d 368.

Here we have a taxpayer which for many years used the cash receipts and disbursements method, which method was consistent, and which clearly reflected income. Its income which had been received and its expenses which had been disbursed, as clearly reflected its net income as a cash basis taxpayer in the year of its liquidation as in any prior year.

The courts have held that a taxpayer reporting on a purely cash receipts and disbursements method, has no right to accrue either receipts or disbursements, and have held that the method consistently followed may affect either the taxpayer or the government adversely from time to time, but that the fact that it may affect either the taxpayer or the government adversely is not reason for either the Commissioner or the taxpayer to change the method.

Cecil v. Commissioner of Internal Revenue,
100 F. 2d 896;

Osterloh v. Lucas, 37 F. 2d 277;

J. H. Martinus & Sons v. Commissioner of Internal Revenue, 116 F. 2d 732;

United States v. Mitchell, 46 S. Ct. 419, 271 U.S. 9, 70 L. Ed. 799.

CHANGES BY COMMISSIONER.

In this case, the Commissioner has selected a classification of income, namely interest, on loans made by the bank evidenced by notes which had not matured, and the interest on which was not due nor payable. Admittedly, interest on this type of obliga-

tion is the main source of a bank's income; and, on some of the notes the interest had been accruing from during the prior year.

The Commissioner has accrued such interest income into the taxable year of liquidation, solely because of the liquidation. The determination of the Commissioner was made solely for the reason that the banking corporation had liquidated.

Had the Wendell bank continued in existence, it could hardly be said that the Commissioner would have been entitled to make any such a change, either in the year involved here or in any other year.

The Wendell bank, as every bank, has expenses attributable to the production of income and to the production of its interest to be received on its outstanding loans. Such expenses include but are by no means limited to, ad valorem and other taxes not due at the time of liquidation. None of the expenses were accrued by the Commissioner to the time of liquidation nor for the taxable period in the year of liquidation.

The acts of the Commissioner created a distortion of income in the taxable period in question.

DISTRIBUTION BY CORPORATION ON DISSOLUTION.

This court has held that distribution to the shareholders of accrued items of income, in the process of dissolution and distribution of a cash basis corporate taxpayer, is not an assignment of anticipatory

income and has held that where such shareholders receive money or other property which would have been taxable income to the corporation at the time if it were still in existence, the corporation is not taxable thereon. Upon liquidation and distribution of the assets of a corporation, to its shareholders, income derived from the property is reportable by the recipient of the distributed share.

United States v. Horschel, 205 F. 2d 646;
Commissioner of Internal Revenue v. Henry Hess Co., 210 F. 2d 553;
Herbert v. Riddell, 103 F. Supp. 369;
Telephone Directory Advertising Co. v. United States, 142 F. Supp. 884.

The lower court should be reversed.

Dated, Boise, Idaho,
 July 11, 1958.

MYRON E. ANDERSON,
 ANDERSON, KAUFMAN AND ANDERSON,
 By EUGENE H. ANDERSON,
Attorneys for Appellant.

(Appendix Follows.)

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1. The first part of the document is a list of names and dates, which appears to be a record of some kind. The names are written in a cursive script, and the dates are in a more formal, printed style. The list is organized into two columns, with names on the left and dates on the right.

2. The second part of the document is a series of short, handwritten notes or entries. These are written in a cursive script and are arranged in a single column. The notes appear to be related to the names and dates in the first part, possibly providing additional information or commentary.

3. The third part of the document is a series of short, handwritten notes or entries. These are written in a cursive script and are arranged in a single column. The notes appear to be related to the names and dates in the first part, possibly providing additional information or commentary.

4. The fourth part of the document is a series of short, handwritten notes or entries. These are written in a cursive script and are arranged in a single column. The notes appear to be related to the names and dates in the first part, possibly providing additional information or commentary.

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(continued)

Appendix.



Appendix

Exhibits	Identified, Offered and Received in Evidence
EXHIBIT A. Resolution for dissolution and distribution of assets of Wendell National Bank	Tr. 18 (Stip. No. 5)
EXHIBIT B. Affidavit of Virginia Dodge, C.P.A., that Wendell National Bank reported its income on cash basis of accounting	Tr. 18 (Stip. No. 8)
EXHIBIT C. Copy of income tax return of Wendell National Bank for period January 1, 1952 to May 10, 1952	Tr. 19 (Stip. No. 9)
EXHIBIT D. Claim for refund	Tr. 22 (Stip. No. 20)
EXHIBIT E. Federal income tax return of Austin and Eda Schouweiler for the year 1952	Tr. 23 (Stip. No. 23)
EXHIBIT F. Notice of rejection of claim for refund	Tr. 23 (Stip. No. 24)

liberated

United States Court of Appeals
for the Ninth Circuit

THE IDAHO FIRST NATIONAL BANK,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO,
SOUTHERN DIVISION

HONORABLE WILLIAM HEALY, *Acting District Judge*

BRIEF OF AMICI CURIAE

HOWE, DAVIS, RIESE & JONES
JOHN M. DAVIS and
JAMES H. MADISON,
Amici Curiae.

977 Dexter Horton Building,
Seattle 4, Washington.



United States Court of Appeals
for the Ninth Circuit

THE IDAHO FIRST NATIONAL BANK,

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INDEX

	<i>Page</i>
I. INTEREST OF AMICI CURIAE.....	1
II. ARGUMENT	2
A. Argument in Support of Reversal of Decision of Lower Court.....	2
1. Wendell National Bank had a right to re- port its income on the "cash basis" and this method of accounting clearly and accurately reflected the income of the bank.....	2
2. In the event the Commissioner could change the method of accounting of the Wendell Bank, he must change it to a recognized "method" of accounting and not to the dis- torted method of accounting adopted by the Commissioner in this case.....	4
3. Summary of argument that the Wendell Bank properly reported its income and the Commissioner erred in including accrued interest in the final income tax return of the Wendell Bank	7
B. Answer to Argument That Some Interest on Notes Held by Wendell Bank Is Not Reported as Income	8
C. Conclusion	11

TABLE OF AUTHORITIES

	<i>Page</i>
Cases	
<i>Huntington Securities Corporation v. Busey</i> , 112 F.(2d) 368 (6th Cir., 1940).....	2, 4
<i>Security Flour Mills Company v. Commissioner of Internal Revenue</i> , 321 U.S. 281, 88 L.Ed. 725, 64 S.Ct. 596 (1944).....	4, 5
<i>Waldheim Realty and Investment Company v. Com- missioner of Internal Revenue</i> , 245 F.(2d) 823 (8th Cir., 1947).....	5
Statutes	
26 U.S.C.A. (Internal Revenue Code, 1939) Sec. 41	3, 4, 6
Regulations	
U.S. Treasury Regulation, 111, Sec. 29.41-2.....	2, 3, 4, 6
U.S. Treasury Regulation, 111, Sec. 29.52-1.....	8, 9
Texts	
3 CCH 1958 Stand. Fed. Tax Rep., Para. 2982.05.....	6

United States Court of Appeals

for the Ninth Circuit

THE IDAHO FIRST NATIONAL BANK,
Appellant,

vs.

UNITED STATES OF AMERICA, *Appellee.*

No. 16004

BRIEF OF AMICI CURIAE

I. INTEREST OF AMICI CURIAE

Pursuant to leave of this court heretofore granted under date of August 18, 1958, and consented to by the parties to this appeal, the writers of this brief join with the Appellant in urging that the decision of the lower court be reversed.

The writers of this brief represent Miners & Merchants Bank of Chelan, Washington, which was placed in voluntary liquidation on January 31, 1953, and whose assets were distributed to its stockholders immediately after it was placed in voluntary liquidation. This bank was a cash basis taxpayer and at the time of its liquidation held certain notes and obligations upon which there was accrued interest. The Commissioner of Internal Revenue has taken the position that this accrued interest was includable in the income of Miners & Merchants Bank during its final taxable year and the bank has contested this position. The issue raised by this contest

is identical with that raised in the present appeal and the ultimate determination of this issue will undoubtedly turn upon the outcome of this appeal. These facts are the basis of the interest of the writers of this brief in urging the reversal of the decision of the lower court.

II. ARGUMENT

A. Argument in Support of Reversal of Decision of Lower Court.

1. **Wendell National Bank had a right to report its income on the "cash basis" and this method of accounting clearly and accurately reflected the income of the bank.**

Wendell National Bank (hereinafter called "Wendell Bank") had the right and was required under the Internal Revenue Acts, Regulations and Decisions to report its income for income tax purposes on the "cash basis" or on the "accrual basis." *Huntington Securities Corporation v. Busey*, 112 F.(2d) 368 (6th Cir., 1940), particularly at page 370. The bank chose to report its income for tax purposes on the "cash basis" which means on a cash receipts and disbursements method of accounting (Tr. 18, 25). Under this method of accounting, all items of gross income are included in the taxable year in which they are received by the taxpayer (or are constructively received in certain instances), and deductions are taken in the year in which they are paid by the taxpayer. Accrued interest is not includable in income of a cash basis taxpayer either on unmatured or past due obligations. See U.S. Treasury Regulation 111, Sec. 29.41-2. The right of Wendell Bank to have

selected the cash basis for reporting its income for tax purposes is further emphasized by the fact that the Commissioner of Internal Revenue at no time questioned the basis selected by it. In fact, when the final income tax return of the Wendell Bank, for the period ending May 10, 1952, was filed on the "accrual basis," the Commissioner upon first examining the return eliminated accrued interest from the income of the Wendell Bank on the ground that the Wendell Bank, a cash basis taxpayer, erroneously included accrued interest as "income" (Tr. 19, 20, 26, 27).

In pursuing the cash basis for reporting for income tax purposes, the Wendell Bank did not include as "income" any obligations to it for interest, whether due and payable or not yet due and payable, at the close of any taxable year.

Once having selected the cash basis of accounting for income tax purposes, the Wendell Bank is required to use that same basis consistently, year after year, and will not be permitted to change to the "accrual basis," except upon receiving the consent of the Commissioner. U.S. Treasury Regulation 111, Sec. 29.41-2. Thus, in the first instance, the Wendell Bank is required to file its final tax return on the same basis on which it has filed all prior returns, namely, the cash basis. It is the position of the Appellant that such cash basis of accounting clearly reflected income, within the requirement of 26 U.S.C.A. (Internal Revenue Code, 1939) Sec. 41, relating to accounting period and methods.

2. In the event the Commissioner could change the method of accounting of the Wendell Bank, he must change it to a recognized "method" of accounting and not to the distorted method of accounting adopted by the Commissioner in this case.

The Commissioner of Internal Revenue is now claiming that the method employed by the Wendell Bank does not clearly reflect the income for the period ending May 10, 1952. We do not concede that he is correct in that determination. Assuming, however, for the moment, that the method employed by the Wendell Bank did not clearly reflect the income of the bank for the tax year involved, then the authority of the Commissioner of Internal Revenue under 26 U.S.C.A. (Internal Revenue Code, 1939) Sec. 41, is to compute the income according to some other "method," being a method which in the opinion of the Commissioner does clearly reflect the income.

We urge that the Commissioner has no authority under the aforesaid section of the Internal Revenue Code or any other section to make any computation of the income of the Wendell Bank other than according to a recognized "method" of accounting. U.S. Treasury Regulation 111, Sec. 29.41-2. Basically, the two recognized "methods" are the cash basis method and the accrual basis method. *Huntington Securities Corporation v. Busey, supra*. Thus, still assuming that the cash basis method did not "clearly reflect income" of the Wendell Bank for the period involved, the Commissioner could only change the bank to the "accrual method" for the period involved. See *Security Flour*

Mills Company v. Commissioner of Internal Revenue, 321 U.S.281, 88 L.Ed. 725, 64 S.Ct. 596 (1944), wherein the Supreme Court of the United States clearly recognized the proposition that neither the Commissioner nor the taxpayer can substitute a divided and inconsistent method of accounting not properly to be denominated either a cash or an accrual system. At pages 285 and 286, the Supreme Court further stated the following to be the well understood and consistently applied doctrine:

“ . . . Cash receipts on matured accounts due on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system and, for the benefit of the Government or the taxpayer, treated on a basis which is neither a cash basis nor an accrual basis, because so to do would, in a given instance, work a supposedly more equitable result to the Government or to the taxpayer.”

The recent case of *Waldheim Realty and Investment Company v. Commissioner*, 245 F.(2d) 823 (8th Cir., 1947), follows the ruling of the Supreme Court that a hybrid basis of accounting is not permitted and prohibited the Commissioner from applying an accrual basis of accounting to a portion of the expenses of a cash basis taxpayer.

In making such a change, the Commissioner must, of course, accrue all items of expense and deductions as well as all items of income on the accrual basis in the income tax return for the close of the tax period in-

volved. See particularly the second sentence of U.S. Treasury Regulation 111, Sec. 29.41-2, which states:

“ . . . A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency . . . ”

In addition, for the change to the “accrual method” to clearly reflect the income of the bank for the period involved, it is well settled that the Commissioner must place the bank on an accrual basis as of the beginning of the period involved. 3 CCH 1958 Stand. Fed. Tax Rep., Para. 2982.05. Then, only by this change of method could the Commissioner properly urge that the accrual method which he adopted “clearly reflected income” for the period involved.

The limitation of the right of the Commissioner with respect to the method of computing income, set forth in 26 U.S.C.A. (Internal Revenue Code, 1939) Sec. 41, was for the purpose of preventing the distortion of income such as is produced by the actions of the Commissioner in connection with the Wendell Bank. The Wendell Bank should pay an income tax for the tax period involved based on a method of accounting which clearly reflects income. Either a true cash basis of accounting for the year or an accrual basis of accounting for the year, as above set forth, would “clearly reflect income.”

When the Commissioner endeavors, however, to accrue interest on notes held by the Wendell Bank, where the interest has not yet been paid to the bank before the

end of the tax year involved, he is distorting the income of the bank and not computing it in accordance with any "method" of accounting. For example: Items of interest which had accrued at December 31, 1951, are included by the Commissioner in the income of the Wendell Bank for the year commencing January 1, 1952, and ending May 10, 1952. Further, unpaid accrued expenses at the date of liquidation were not deducted (Tr. 19, 26).

3. Summary of argument that the Wendell Bank properly reported its income and the Commissioner erred in including accrued interest in the final income tax return of the Wendell Bank.

To summarize this portion of the argument, it is our position:

(1) That the Wendell Bank was on a consistent and established cash basis of accounting for income tax purposes which clearly reflected income and which had never been challenged by the Internal Revenue Service, and that it was required therefore to file its final income tax return upon the same basis.

(2) That in the event the cash basis did not clearly reflect the income of the Wendell Bank, then the Commissioner of Internal Revenue has authority to change the accounting basis to the "accrual basis" for the period involved. In making the change to the accrual basis, all items of income and all items of expense and deductions must be accrued at the close of the preceding tax period, December 31, 1951, and at the close of the final tax period, May 10, 1952, and the income computed

under the accrual basis of accounting for the tax year involved.

(3) That it is beyond the power of the Commissioner to single out accrued interest on loans as of May 10, 1952, and arbitrarily add that item to income because this inconsistency produces a distortion of income and makes the accounting for the Wendell Bank for its final tax year on a basis other than a recognized "method of accounting," to-wit: either the cash basis or the accrual basis.

B. Answer to Argument That Some Interest on Notes Held by Wendell Bank Is Not Reported as Income

On May 10, 1952, the Wendell Bank was completely dissolved by the distribution of a liquidating dividend to the stockholders of the bank (Tr. 25). The corporation retained no assets after that date. Under U.S. Treasury Regulation 111, Sec. 29.52-1, the corporation is not in existence after May 10, 1952, even though it may continue as a corporation for certain limited purposes such as for the purpose of suing and being sued. Certainly in promulgating the regulations, the Commissioner of Internal Revenue had in mind that the liquidating corporation might be either on the cash basis or the accrual basis of accounting.

There is no hint in the regulations that such a corporation be required, in its final year, to change its method of accounting. Thus, it must have been known by the Commissioner of Internal Revenue that a cash basis corporation might distribute all of its assets and close

its taxable year. It must have been contemplated by the Commissioner that there would be accrued interest and accrual items of every kind, both income and expense, upon the books of such a liquidating corporation which was on the cash basis.

Presumably, the regulation could have provided that the corporation would continue in existence for tax purposes, if it were on the cash basis, until such time as the accrued items of expense had been paid and the accrued items of income had been received. However, U.S. Treasury Regulation 111, Sec. 29.52-1 provides to the contrary. Therefore, it is our position that after the liquidation of a cash basis taxpayer the stockholder or stockholders receiving the distribution must report on their income tax returns all of the income received by them after the date of dissolution. In this case the sole stockholder, at the time of dissolution, was the Appellant, The Idaho First National Bank.

For example, if the Wendell Bank on September 10, 1951, had made a loan of \$100.00, taking a promissory note due in one year with interest at the rate of 6% per annum, the following tax consequences would apply:

(1) There would be no income shown by the Wendell Bank at December 31, 1951, on the note, since the Wendell Bank was on the cash basis of accounting.

(2) There would be no income shown by the Wendell Bank in its final tax return for the period ending May 10, 1952, because it remains on the cash basis of accounting.

(3) When the stockholder of the Wendell Bank, who received a distribution of the note on May 10, 1952, collected \$106.00 on September 10, 1952, the stockholder would have to report as income \$6.00.

(4) In the event that the contention of the Government is sustained, and the Wendell Bank must report as income the \$4.00 which had accrued as interest on the note by May 10, 1952, then the stockholder would be given a basis of \$104.00 in the note and would only have to report as income on September 10, 1952, the sum of \$2.00.

(5) Even if the contention of the Commissioner should be sustained that the cash method of accounting does not clearly reflect the income of the Wendell Bank for the period ending May 10, 1952, the Commissioner must put the bank on a recognized method, the accrual method of accounting. Upon this method it should be permitted to reflect as income for the period from January 1 to May 10, 1952, only that portion of the \$4.00 total interest accrual on the note by May 10, 1952, which accrued after January 1, 1952, or the sum of \$2.17. We submit that this handling of the situation would, however, give a basis of \$104.00 to the stockholder, who then would have to report as gross income only the \$2.00 additional when he received payment of \$106.00 on September 10, 1952.

(6) In the event the Commissioner is successful in putting the Wendell Bank upon the accrual basis, the \$1.83 of interest accrued at December 31, 1951, would

be subject to tax in the year 1951 if the Commissioner put the Wendell Bank on the accrual basis for that year.

Thus, it is apparent that under any handling of the situation the entire \$6.00 will be reported as a part of the gross income of some taxpayer. The argument that some of the accrued interest in the case of the Wendell Bank would not be reported as income by any taxpayer we submit is in error.

C. Conclusion

In conclusion, it is submitted that:

(1) The District Court judgment should be reversed and the final income tax return of the Wendell Bank should be permitted to stand upon its present basis, computed upon the cash receipts and disbursements method of accounting.

(2) That if the Commissioner has demonstrated that the cash basis does not clearly reflect income of the Wendell Bank for the period involved, he must put the bank upon a recognized method of accounting other than the "cash basis," and this means that he must put it upon the "accrual basis" for the tax period involved. Putting the bank upon the accrual basis means that income, expense and deductions must be reflected in the final year based upon the increase or decrease from those accruals existing at the beginning of the period. Otherwise, the accrual method selected by the Commissioner would "not clearly reflect income" for the period

involved, but would on the contrary result in a gross distortion of income.

It is respectfully submitted by the writers of this brief that the decision of the District Court should be reversed and that judgment should be entered in favor of the appellant in accordance with the prayer of its complaint.

Respectfully submitted,

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No. 16004

**In the United States
Court of Appeals
For the Ninth Circuit**

THE IDAHO FIRST NATIONAL BANK, Appellant

v.

UNITED STATES OF AMERICA, Appellee

**ON APPEAL FROM THE JUDGMENT
OF THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO,
SOUTHERN DIVISION**

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I N D E X

	Page
OPINION BELOW	3
JURISDICTION	3
QUESTION PRESENTED	3
STATUTE AND REGULATIONS INVOLVED ..	4
STATEMENT	4
SUMMARY OF ARGUMENT	6
Argument:	
The District Court correctly upheld the Commissioner's determination that the accrued interest is taxable to Wendell	7
CONCLUSION	22
APPENDIX A	23
APPENDIX B	30

CITATIONS

Cases:	Page
<i>Automobile Club v. Commissioner</i> , 353 U.S. 180 .	11
<i>Brown v. Commissioner</i> , 22 T. C. 147, affirmed, 220 F. 2d 12	11, 19
<i>Brown v. Helvering</i> , 291 U.S. 193	11
<i>Carter v. Commissioner</i> , 9 T. C. 364, affirmed on another issue, 170 F. 2d 911	10, 11
<i>Commissioner v. Ashland Oil & R. Co.</i> , 99 F. 2d 588, certiorari denied, 306 U.S. 661	12, 19
<i>Commissioner v. Glenshaw Glass Co.</i> , 348 U.S. 426	11
<i>Commissioner v. Henry Hess Co.</i> , 210 F. 2d 553	15, 20
<i>Commissioner v. Lake</i> , 356 U.S. 260	11, 13
<i>Daley v. United States</i> , 243 F. 2d 466, certiorari denied, 355 U.S. 832	14
<i>Dillard-Waltermire v. Campbell</i> , 255 F. 2d 433 ..	10
<i>Fisher v. Commissioner</i> , 209 F. 2d 513, certiorari denied, 347 U.S. 1014	13
<i>Floyd v. Scofield</i> , 193 F. 2d 594	10
<i>Goodrich v. Commissioner</i> , 243 F. 2d 686	16

CITATIONS

Cases:	Page
<i>Helvering v. Eubank</i> , 311 U.S. 122	9, 11
<i>Helvering v. Horst</i> , 311 U.S. 112	9, 11
<i>Helvering v. Taylor</i> , 293 U.S. 507	15
<i>Herbert v. Riddell</i> , 103 F. Supp. 369	15
<i>Hort v. Commissioner</i> , 313 U.S. 28	13
<i>Jud Plumbing & Heating v. Commissioner</i> , 153 F. 2d 681	15, 16, 18, 20, 21
<i>Kahuku Plantation Co. v. Commissioner</i> , 132 F. 2d 671	17
<i>Kimbell-Diamond Milling Co. v. Commissioner</i> , 14 T.C. 74, affirmed, 187 F. 2d 718	12, 19
<i>Lucas v. American Code Co.</i> , 280 U.S. 445	11
<i>Lucas v. Earl</i> , 281 U.S. 111	11
<i>Martinus & Sons v. Commissioner</i> , 116 F. 2d 732	13
<i>Mass. Mutual Life Ins. Co. v. United States</i> , 288 U.S. 269	17
<i>Miller & Vidor Lumber Co. v. Commissioner</i> , 39 F. 2d 890, certiorari denied, 282 U.S. 864	13
<i>Minnesota Tea Co. v. Helvering</i> , 302 U.S. 609	13

CITATIONS

Cases:	Page
<i>Osterloh v. Lucas</i> , 37 F. 2d 277	13
<i>Patchen v. Commissioner</i> , decided July 23, 1958 .	16
<i>Schram v. United States</i> , 118 F. 2d 541	17
<i>Security Mills Co. v. Commissioner</i> , 321 U.S. 281	17
<i>SoRelle v. Commissioner</i> , 22 T.C. 459	17
<i>Spring City Co. v. Commissioner</i> , 292 U.S. 182 ..	14
<i>Standard Paving Co. v. Commissioner</i> , 190 F. F. 2d 330, certiorari denied, 342 U.S. 860	10
<i>Suter, Estate of v. Commissioner</i> , 29 T.C. 244	12, 15, 19
<i>Telephone Directory Advertising Co. v. United States</i> , 142 F. Supp. 884	15
<i>United States v. Anderson</i> , 269 U.S. 422	14
<i>United States v. Cumberland Pub. Serv. Co.</i> 338 U.S. 451	12
<i>United States v. Horschel</i> , 205 F. 2d 646	15, 20
<i>United States v. Loo</i> , 248 F. 2d 765, certiorari denied, 356 U.S. 928	20

CITATIONS

Cases:	Page
<i>United States v. Lynch</i> , 192 F. 2d 718, certiorari denied, 343 U.S. 934 7, 10, 11, 15, 16, 18, 19, 20, 21	
<i>United States v. Snow</i> , 223 F. 2d 103, certiorari denied, 350 U.S. 831	13
<i>Waldheim Realty & Inv. Co. v. Commissioner</i> , 245 F. 2d 823	18

Statutes:

Internal Revenue Code of 1939:

Sec. 22 (26 U.S.C. 1952 ed., Sec. 22) ..	7, 11, 23
Sec. 41 (26 U.S.C. 1952 ed., Sec. 41)	7, 8, 10, 11, 23
Sec. 42 (26 U.S.C. 1952 ed., Sec. 42)	11, 24
Sec. 45 (26 U.S.C. 1952 ed., Sec. 45) ..	7, 11, 24
Sec. 47 (26 U.S.C. 1952 ed., Sec. 47)	24
Sec. 48 (26 U.S.C. 1952 ed., Sec. 48)	25
Sec. 52 (26 U.S.C. 1952 ed., Sec. 52)	26

Internal Revenue Code of 1954, Sec. 446(c) (26 U.S.C. 1952 ed., Supp. II, Sec. 446(c)) ..	17
---	----

CITATIONS

Cases:	Page
--------	------

Miscellaneous:

2 Mertens, Law of Federal Income
Taxation (1955 ed.) :

Sec. 12.05a	17
-------------------	----

Sec. 12.95	13
------------------	----

Sec. 17.17	20
------------------	----

Rev. Rul. 255, 1953-2 Cum. Bull. 10	10, 12
---	--------

Treasury Regulations 111, Sec. 29.52-1	20
--	----

Treasury Regulations 118:

Sec. 39.22(a)-20	11, 26
------------------------	--------

Sec. 39.41-1	26
--------------------	----

Sec. 39.41-2	27
--------------------	----

Sec. 39.41-3	28
--------------------	----

Sec. 39.52-1	20, 28
--------------------	--------

CONTENTS

1897

Miscellaneous	1
1897	2
1898	3
1899	4
1900	5
1901	6
1902	7
1903	8
1904	9
1905	10
1906	11
1907	12
1908	13
1909	14
1910	15
1911	16
1912	17
1913	18
1914	19
1915	20
1916	21
1917	22
1918	23
1919	24
1920	25
1921	26
1922	27
1923	28
1924	29
1925	30
1926	31
1927	32
1928	33
1929	34
1930	35
1931	36
1932	37
1933	38
1934	39
1935	40
1936	41
1937	42
1938	43
1939	44
1940	45
1941	46
1942	47
1943	48
1944	49
1945	50
1946	51
1947	52
1948	53
1949	54
1950	55
1951	56
1952	57
1953	58
1954	59
1955	60
1956	61
1957	62
1958	63
1959	64
1960	65
1961	66
1962	67
1963	68
1964	69
1965	70
1966	71
1967	72
1968	73
1969	74
1970	75
1971	76
1972	77
1973	78
1974	79
1975	80
1976	81
1977	82
1978	83
1979	84
1980	85
1981	86
1982	87
1983	88
1984	89
1985	90
1986	91
1987	92
1988	93
1989	94
1990	95
1991	96
1992	97
1993	98
1994	99
1995	100
1996	101
1997	102
1998	103
1999	104
2000	105
2001	106
2002	107
2003	108
2004	109
2005	110
2006	111
2007	112
2008	113
2009	114
2010	115
2011	116
2012	117
2013	118
2014	119
2015	120
2016	121
2017	122
2018	123
2019	124
2020	125
2021	126
2022	127
2023	128
2024	129
2025	130
2026	131
2027	132
2028	133
2029	134
2030	135
2031	136
2032	137
2033	138
2034	139
2035	140
2036	141
2037	142
2038	143
2039	144
2040	145
2041	146
2042	147
2043	148
2044	149
2045	150
2046	151
2047	152
2048	153
2049	154
2050	155
2051	156
2052	157
2053	158
2054	159
2055	160
2056	161
2057	162
2058	163
2059	164
2060	165
2061	166
2062	167
2063	168
2064	169
2065	170
2066	171
2067	172
2068	173
2069	174
2070	175
2071	176
2072	177
2073	178
2074	179
2075	180
2076	181
2077	182
2078	183
2079	184
2080	185
2081	186
2082	187
2083	188
2084	189
2085	190
2086	191
2087	192
2088	193
2089	194
2090	195
2091	196
2092	197
2093	198
2094	199
2095	200
2096	201
2097	202
2098	203
2099	204
2100	205
2101	206
2102	207
2103	208
2104	209
2105	210
2106	211
2107	212
2108	213
2109	214
2110	215
2111	216
2112	217
2113	218
2114	219
2115	220
2116	221
2117	222
2118	223
2119	224
2120	225
2121	226
2122	227
2123	228
2124	229
2125	230
2126	231
2127	232
2128	233
2129	234
2130	235
2131	236
2132	237
2133	238
2134	239
2135	240
2136	241
2137	242
2138	243
2139	244
2140	245
2141	246
2142	247
2143	248
2144	249
2145	250
2146	251
2147	252
2148	253
2149	254
2150	255
2151	256
2152	257
2153	258
2154	259
2155	260
2156	261
2157	262
2158	263
2159	264
2160	265
2161	266
2162	267
2163	268
2164	269
2165	270
2166	271
2167	272
2168	273
2169	274
2170	275
2171	276
2172	277
2173	278
2174	279
2175	280
2176	281
2177	282
2178	283
2179	284
2180	285
2181	286
2182	287
2183	288
2184	289
2185	290
2186	291
2187	292
2188	293
2189	294
2190	295
2191	296
2192	297
2193	298
2194	299
2195	300
2196	301
2197	302
2198	303
2199	304
2200	305
2201	306
2202	307
2203	308
2204	309
2205	310
2206	311
2207	312
2208	313
2209	314
2210	315
2211	316
2212	317
2213	318
2214	319
2215	320
2216	321
2217	322
2218	323
2219	324
2220	325
2221	326
2222	327
2223	328
2224	329
2225	330
2226	331
2227	332
2228	333
2229	334
2230	335
2231	336
2232	337
2233	338
2234	339
2235	340
2236	341
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OPINION BELOW

The memorandum of decision,¹ findings of fact and conclusions of law of the District Court (R. 24-31) are not officially reported.

JURISDICTION

This appeal involves income taxes for the period from January 1, 1952, to May 10, 1952, in the sum of \$3,957.36 allegedly overpaid by the taxpayer as transferee of the assets of the Wendell National Bank, together with interest as provided by law. (R. 3-11.) On May 29, 1956, taxpayer paid the transferee assessment of \$3,957.36, plus interest of \$896.22, or a total of \$4,853.58; and on the same day, taxpayer filed a claim for refund. (R. 22, 29.) The Commissioner of Internal Revenue rejected the claim for refund on July 5, 1956. (R. 23, 30.) On July 24, 1956, and within the time prescribed by Section 3772 of the Internal Revenue Code of 1939, this suit was instituted in the District Court. Jurisdiction was conferred on the District Court by 28 U.S.C., Sections 1340 and 1346. Judgment was entered against the taxpayer on January 27, 1958. (R. 31-32.) Within sixty days thereafter, and on March 19, 1958, a notice of appeal to this Court was filed by taxpayer. (R. 32-33.) Jurisdiction is conferred upon this Court by 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether the District Court correctly upheld the determination of the Commissioner of Internal Revenue that accrued interest on notes receivable was

1/ The memorandum of decision is not included in the printed record, and a copy is attached as Appendix B, *infra*.

reportable as income by a cash basis bank for the taxable period ending with its liquidation.

STATUTE AND REGULATIONS INVOLVED

These are set out in Appendix A, *infra*

STATEMENT

The facts as stipulated (R. 16-23) and found by the District Court (R. 24-30) may be summarized as follows:

Prior to May 10, 1952, the Wendell National Bank (Sometimes referred to as "Wendell" herein) was a corporation organized and existing under the National Bank Act, with its principal place of business at Wendell, Idaho. (R. 17, 24.)

On May 10, 1952, the taxpayer² (plaintiff-appellant herein) purchased the entire capital stock of the Wendell National Bank for the sole purpose of acquiring its assets. On the same day, and immediately after the purchase, a special meeting of stockholders was held and a resolution was passed authorizing dissolution of Wendell and distribution of all its assets to taxpayer. On the same day (May 10, 1952), and in accordance with this resolution, all the assets of Wendell were distributed to taxpayer and all liabilities of Wendell were assumed by the taxpayer. Thereafter, Wendell was fully liquidated for all intents and purposes. (R. 17-18, 24-25.)

2/ The term "taxpayer" is used herein for convenience in referring to the transferee. The Idaho First National Bank, although the transferor, Wendell National Bank, is the original taxpayer whose taxes are involved. No question as to transferee liability is presented and it is stipulated and found (R. 22, 29) that plaintiff in paying the transferee assessment has the right to contest the tax issue of the transferor and is liable as transferee for any additional tax owed by the transferor. See Section 311 of the Internal Revenue Code of 1939.

Wendell National Bank was in the general banking business and consistently reported its income on the cash basis method of accounting. On June 20, 1952, a corporation income tax return for the period January 1, 1952, through May 10, 1952, was filed in behalf of Wendell, and the tax shown to be due on the return was paid by the taxpayer. In that return there was included as taxable income the accrued interest on notes receivable in the amount of \$10,843.55. This accrued interest on notes receivable was calculated at the time of Wendell's liquidation in order to determine the value of its assets for liquidation purposes, and it was calculated by computing the interest earned but not then payable on each note to the date of liquidation. Expenses attributable to this accrued interest on notes receivable had been deducted for income tax purposes when paid by Wendell prior to its liquidation. Unpaid accrued expenses of Wendell had not been deducted for income tax purposes at the date of liquidation. (R. 18-19, 25-26.)

The accrued interest was collected by taxpayer subsequent to the liquidation of Wendell, and when so collected was reported by taxpayer as income for tax purposes. However, taxpayer offset the collections against the allocated cost of the accrued interest on notes receivable, so that all of the amount collected was treated as recovery of cost and therefore not subject to income tax. (R. 23, 29-30.)

The individual stockholders of Wendell who sold their stock to taxpayer paid a capital gains tax on the excess of the selling price over the cost or other basis of their stock. (R. 23, 30.)

The Internal Revenue Service at first concluded

that the accrued interest was not taxable to Wendell since it was on the cash basis; and a refund was made to taxpayer accordingly. However, the matter was subsequently reconsidered, and after such reconsideration, the Commissioner of Internal Revenue changed his views and determined that the accrued interest was taxable to Wendell and that it should be included in the final return of Wendell for the short period (January 1, 1952, to May 10, 1952) ending with its liquidation. The Commissioner also determined that the amount of such accrued interest was \$13,191.19 instead of \$10,843.55. Accordingly, a deficiency notice was issued to taxpayer as transferee of Wendell's assets, and on May 29, 1956, taxpayer paid the transferee assessment of \$3,957.36, plus interest of \$896.22, or a total of \$4,853.58. Taxpayer then filed a timely claim for refund, and after rejection of such claim taxpayer instituted this suit in the District Court. (R. 19-23, 26-30.)

The District Court upheld the Commissioner's determination and directed dismissal of taxpayer's complaint. (R. 30.) Judgment was entered in favor of the United States accordingly (R. 31-32), and taxpayer has appealed to this Court (R. 32-33).

SUMMARY OF ARGUMENT

The District Court correctly upheld the determination of the Commissioner of Internal Revenue that interest earned on notes receivable should be accrued to the date of liquidation of the Wendal National Bank and included in its final income tax return for the short period ending with its liquidation, notwithstanding the fact that it reported its income on the cash basis. That is so because Wendell's earnings

belonged to it and liability to tax thereon could not be discharged by the simple expedient of liquidation and distribution of the right to such income. This income was in fact realized by the transferor (Wendell) and should therefore be attributed to it without any special inquiry as to whether it was on the cash or accrual basis. And in the circumstances the Commissioner had the power and duty under Sections 22(a), 41 and 45 of the 1939 Code to tax this income to Wendell without regard to whether it was on the cash or accrual basis of accounting. Although the cash basis may have sufficed to clearly reflect Wendell's income during prior years, the situation was changed on account of its liquidation. This change prevented Wendell's accounting technique from clearly reflecting its income for the short period ending with its liquidation and justified the Commissioner in exercising his discretionary powers to protect the revenue. The decision of the District Court to that effect is in accord with the law, the Regulations and the court decisions, and it should accordingly be upheld by this Court.

ARGUMENT

THE DISTRICT COURT CORRECTLY UPHELD THE COMMISSIONER'S DETERMINATION THAT THE ACCRUED INTEREST IS TAX- ABLE TO WENDELL

We submit that this case was correctly decided by the District Court and its decision is supported by *United States v. Lynch*, 192 F. 2d 718 (C. A. 9th), certiorari denied, 343 U.S. 934. In that case it appeared that the corporation whose taxes were involved had followed the custom of reporting, for in-

come tax purposes, the expenses of warehousing activities on the accrual basis. However, storage income was not reported until the goods were withdrawn from storage and bills had been rendered and paid. Such a system had resulted in approximate matching of corporate expenses and revenues for the reason that in the ordinary course of business goods were stored for short terms and usually removed by June 30, the end of the corporation's taxable year. The last corporate tax return for the period ending with the liquidation of the corporation reported no storage income for goods which had not then been removed. The Commissioner held that in order to clearly reflect the taxpayer's income for its final tax period, the storage charges should be accrued to the date of liquidation and reported as income although this represented a departure from the method that the corporation had consistently used in the past. This Court held that the Commissioner acted within the limits of the discretion conferred upon him by Section 41 of the Internal Revenue Code of 1939 (Appendix A, *infra*) and that acceptance of the corporation's accounting method in prior years did not prevent the Commissioner from later exercising his statutory power within those limits. And in so holding, this Court said (192 F. 2d at p. 721) :

We think the Commissioner acted within the limits of the discretion conferred upon him by 26 U.S.C.A. §41, “* * * if the [taxpayer's accounting] method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income.” Acceptance of the corporation's account-

ing method in prior years did not prevent the Commissioner from later exercising his statutory power within proper limits. The fundamental change in the corporation's circumstances, that is, its liquidation and consequent non-existence, prevented its accounting technique from achieving the rough matching of expenses and income previously attained.

We understand appellant to contend that the income in question is not that of the corporation. The answer is, that the corporation has performed the services which create the right to the income which brings into play the basic rule that income shall be taxed to him who earns it. *Helvering v. Eubank*, 1940, 311 U.S. 122, 61 S.Ct. 149, 85 L.Ed. 81. A corporate liquidation and transfer of assets cannot divert taxability of income already earned any more than does an assignment of such income. Cf. *Helvering v. Horst*, 1940, 311 U.S. 112, 61 S.Ct. 144, 85 L.Ed. 75; *Helvering v. Eubank*, *supra*. Appellant further argues that granting there was corporate income it should not be taxed to the corporation because of the peculiar circumstances of this case. However, "a taxpayer * * * cannot avoid taxes by the simple expedient of not completing its contracts; and where a corporation puts itself in such a position that it could never complete its contracts, it is in no position to insist that even if it had income it has no tax liability". Cf. *Jud Plumbing & Heating Inc. v. C. I. R.*, 5 Cir., 1946, 153 F. 2d 681, 685. In the cited case a corporation, reporting on the completed contract method, was in effect placed on the accru-

come tax purposes, the expenses of warehousing activities on the accrual basis. However, storage income was not reported until the goods were withdrawn from storage and bills had been rendered and paid. Such a system had resulted in approximate matching of corporate expenses and revenues for the reason that in the ordinary course of business goods were stored for short terms and usually removed by June 30, the end of the corporation's taxable year. The last corporate tax return for the period ending with the liquidation of the corporation reported no storage income for goods which had not then been removed. The Commissioner held that in order to clearly reflect the taxpayer's income for its final tax period, the storage charges should be accrued to the date of liquidation and reported as income although this represented a departure from the method that the corporation had consistently used in the past. This Court held that the Commissioner acted within the limits of the discretion conferred upon him by Section 41 of the Internal Revenue Code of 1939 (Appendix A, *infra*) and that acceptance of the corporation's accounting method in prior years did not prevent the Commissioner from later exercising his statutory power within those limits. And in so holding, this Court said (192 F. 2d at p. 721) :

We think the Commissioner acted within the limits of the discretion conferred upon him by 26 U.S.C.A. §41, “* * * if the [taxpayer's accounting] method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income.” Acceptance of the corporation's account-

The fundamental principle underlying all of these authorities is that the corporation's earnings belong to it and liability to tax thereon cannot be discharged by the simple expedient of liquidation and distribution of the right to such income. See *United States v. Lynch*, *supra*, 192 F. 2d at p. 721; *Carter v. Commissioner*, *supra*, 9 T. C. at pp. 373-374. Cf. *Lucas v. Earl*, 281 U.S. 111; *Helvering v. Horst*, 311 U.S. 112; *Helvering v. Eubank*, 311 U.S. 122; *Commissioner v. Lake*, 356 U.S. 260.

It is elementary that in enacting the gross income statute (Section 22 (a) of the Internal Revenue Code of 1939, *Appendix A. infra*), Congress undertook to exert the full measure of its taxing power (*Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 429); and in order to assist the Commissioner in carrying out the Congressional intent he was given broad discretionary powers with respect to the use of accounting methods and systems so as to clearly reflect the taxable income and thereby protect the revenue. Sections 41, 42 and 45 of the Internal Revenue Code of 1939 (*Appendix A. infra*); cf. *Lucas v. American Code Co.*, 280 U.S. 445, 449; *Brown v. Helvering*, 291 U.S. 193, 204-205; *Automobile Club v. Commissioner*, 353 U.S. 180, 189. It should also be noted that income may be realized in a variety of ways, other than by direct payment to the taxpayer, and, in such situations, the income may be attributed to him when it is in fact realized, without any special inquiry as to whether he is on the cash or accrual basis. *Brown v. Commissioner*, 22 T. C. 147, 151, affirmed, 220 F. 2d 12 (C. A. 7th).

It is true that Section 39.22(a)-20 of Treasury Regulations 118 (*Appendix A. infra*) does provide

that no gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation; but while that provision operates to preclude taxing a corporation on capital gains resulting from sale of the distributed assets by the shareholders (*United States v. Cumberland Pub. Serv. Co.*, 338 U.S. 451), still, it does not apply in respect to income earned by the corporation up to the time of liquidation even though such income has not been received by the corporation. See Rev. Rul. 255, *supra*.

Moreover, the instant transaction amounted in essence to a purchase by taxpayer of Wendell's assets for their fair value and we do not understand this to be disputed. Here taxpayer purchased the entire capital stock of Wendell for the sole purpose of acquiring Wendell's assets; the amount paid for the stock was determined by the value of such assets; and the liquidation and transfer of the assets to taxpayer was consummated on the same day the stock was purchased. (R. 17-18, 24-25.) In the circumstances, the entire transaction, considered as a whole as of course it should be, amounted in substance to a purchase of property with the cost of the stock allocable to the property. *Kimbell-Diamond Milling Co. v. Commissioner*, 14 T. C. 74, affirmed, 187 F. 2d 718 (C. A. 5th); *Commissioner v. Ashland Oil & R. Co.*, 99 F. 2d 588 (C. A. 6th), certiorari denied, 306 U.S. 661; *Estate of Suter v. Commissioner*, 29 T. C. 244, 258-259.

And if we look at the instant situation as a purchase of property including accrued interest on notes receivable then it seems clear that Wendell realized income in the amount of the interest accrued to the

date of liquidation (*Fisher v. Commissioner*, 209 F. 2d 513 (C. A. 6th), certiorari denied, 347 U.S. 1014; *United States v. Snow*, 223 F. 2d 103 (C. A. 9th), certiorari denied, 350 U.S. 831; *Hort v. Commissioner*, 313 U.S. 28; *Commissioner v. Lake*, *supra*) since it was in effect collected as part of the purchase price. As the Court said in *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 313: "A given result at the end of a straight path is not made a different result because reached by following a devious path."

In the circumstances, we submit that the District Court in the instant case rightly concluded that the accrued interest in controversy is taxable to Wendell as determined by the Commissioner.

The taxpayer says (Br. 9-11) that the Wendell bank had for many years consistently used the cash basis of accounting and that a taxpayer reporting on a cash basis must be consistent and cannot accrue either receipts or disbursements. We do not dispute this as a general proposition nor do we have any quarrel with cases as *Osterloh v. Lucas*, 37 F. 2d 277 (C. A. 9th) and *Martinus & Sons v. Commissioner*, 116 F. 2d 732 (C. A. 9th), cited by taxpayer. Indeed, we note that Judge Healy of this Court, who acted as a District Judge in the instant case, wrote the opinion of the Court in the *Martinus* case.

The taxpayer says (Br. 11) that the instant notes had not matured, and the interest on them was not due nor payable at the time of the liquidation. That may be so, but it makes no difference here and it does not show that the interest had not accrued in the accounting sense and for tax purposes as well, since interest, like rent, can be said to accrue from day to day, or ratably over an elapsed period of time. 2 Mer-

tens, *Law of Federal Income Taxation* (1955 ed.), Section 12.95; *Miller & Vidor Lumber Co. v. Commissioner*, 39 F. 2d 890 (C. A. 5th), certiorari denied, 282 U.S. 864. It is the right to receive which is important to determine accruals and when the right to receive an amount becomes fixed, the right accrues even though the amount has not yet become due or payable. *Spring City Co. v. Commissioner*, 292 U.S. 182; *United States v. Anderson*, 269 U.S. 422; *Daley v. United States*, 243 F. 2d 466 (C. A. 9th), certiorari denied, 355 U.S. 832. Indeed we do not understand that there is any dispute as to these principles in the instant case, and it was stipulated and found (R. 23, 29) that the interest in question had accrued at the time of the liquidation. The only question here presented is whether the Commissioner had authority to add this accrued interest to Wendell's income for the short period ending with its liquidation, and we submit that he did for the reasons given in this brief.

The taxpayer says (Br. 12) that Wendell had expenses attributable to this accrued interest, and such expenses were not accrued by the Commissioner to the time of liquidation. However, the stipulation and finding show (R. 19, 26) that expenses attributable to this accrued interest had been deducted for income tax purposes when paid by Wendell prior to its liquidation; also that unpaid accrued expenses of Wendell had not been deducted for income tax purposes at the date of liquidation. We may conclude from this that expenses attributable to the accrued interest had been deducted currently prior to the liquidation. But if any of these expenses had not been so deducted, then taxpayer, which had the burden of

which on page 3 gives as an answer to question 9 that the return was prepared on the cash basis. In fact, nobody has contended otherwise, so far as we know, and the fundamental question here presented is whether in the circumstances the Commissioner had authority to require inclusion of accrued interest on notes receivable to the date of Wendell's liquidation even though generally speaking the return was made on the cash basis.

The *amici curiae* contend (Br. 4-7) that the Commissioner can not do this even if necessary to clearly reflect income, and that if the Commissioner wants to make a change he must put Wendell's income and deductions upon an accrual basis for the entire period and not merely add the accrued interest to an otherwise cash basis return as that would result in a hybrid method which is not countenanced by the law.

It may be that hybrid methods are not generally favored, and the general rule is against accounting for and reporting income partly on the cash and partly on the accrual basis. *Mass. Mutual Life Ins. Co. v. United States*, 288 U.S. 269; *Security Mills Co. v. Commissioner*, 321 U.S. 281. However, it is equally clear that hybrid methods are both acceptable and necessary in some instances where they clearly reflect income (*Schram v. United States*, 118 F. 2d 541 (C. A. 6th); *SoRelle v. Commissioner*, 22 T. C. 459, 468-469; 2 Mertens, *Law of Federal Income Taxation* (1955 ed.), Section 12.05a; cf. *Kahuku Plantation Co. v. Commissioner*, 132 F. 2d 671 (C. A. 9th); and, indeed, such methods are explicitly recognized to some extent under Section 446(c) of the the 1954 Code do not represent any radical change

lows the postponement of accrued income, because it more accurately reflected income. In those cases the accrual was made only to the date of liquidation. In all those cases the right to receive the income was fixed and definite and in some instances the income had already been received.

In the instant case, the accrual was made only to the date of liquidation and the right to receive the income was fixed and definite. In the circumstances, the action taken by the Commissioner was well within the bounds of his statutory authority to require computations which clearly reflect income; and as we have pointed out above, the decision of the District Court to that effect is amply supported by authorities such as the *Lynch* decision of this Court and the *Jud Plumbing* case in the Fifth Circuit.³ The taxpayer's objections and criticisms are without merit, and they should be rejected here as they were by Judge Healy in the District Court.

It remains to add a few words as to the brief of the *amici curiae* who have joined the appellant in urging this Court to reverse the decision of the lower court herein. The *amici curiae* state (Br. 3) that the final income tax return of the Wendell Bank, for the period ending May 10, 1952, was filed on the accrual basis. We do not understand that to be so, and we would point to the return itself (Stip. Ex. C)

3/ Cases such as *PATCHEN v. COMMISSIONER*, decided July 23, 1958 (C. A. 5th); and *GOODRICH v. COMMISSIONER*, 243 F. 2d 686 (C. A. 8th) are not in point and do not aid the instant taxpayer irrespective of whether they may be considered correct. Those cases deal with changes in accounting methods of going concerns, while here we are concerned with a liquidated corporation which by its act of liquidating and going out of existence prevented its accounting technique from clearly reflecting its income for the short period ending with its liquidation. See *UNITED STATES v. LYNCH*, SUPRA.

which on page 3 gives as an answer to question 9 that the return was prepared on the cash basis. In fact, nobody has contended otherwise, so far as we know, and the fundamental question here presented is whether in the circumstances the Commissioner had authority to require inclusion of accrued interest on notes receivable to the date of Wendell's liquidation even though generally speaking the return was made on the cash basis.

The *amici curiae* contend (Br. 4-7) that the Commissioner can not do this even if necessary to clearly reflect income, and that if the Commissioner wants to make a change he must put Wendell's income and deductions upon an accrual basis for the entire period and not merely add the accrued interest to an otherwise cash basis return as that would result in a hybrid method which is not countenanced by the law.

It may be that hybrid methods are not generally favored, and the general rule is against accounting for and reporting income partly on the cash and partly on the accrual basis. *Mass. Mutual Life Ins. Co. v. United States*, 288 U.S. 269; *Security Mills Co. v. Commissioner*, 321 U.S. 281. However, it is equally clear that hybrid methods are both acceptable and necessary in some instances where they clearly reflect income (*Schram v. United States*, 118 F. 2d 541 (C. A. 6th) ; *SoRelle v. Commissioner*, 22 T. C. 459, 468-469; 2 Mertens, *Law of Federal Income Taxation* (1955 ed.), Section 12.05a; cf. *Kahuku Plantation Co. v. Commissioner*, 132 F. 2d 671 (C. A. 9th) ; and, indeed, such methods are explicitly recognized to some extent under Section 446(c) of the the 1954 Code do not represent any radical change

here, because here we are dealing with the taxable period ending May 10, 1952, which is governed by the 1939 Code as stated above. However, it would seem appropriate to add that the new provisions of the 1954 Code do not represent any radical change in the law since hybrid methods of accounting although not generally appropriate have long been sanctioned under the 1939 Code and prior law where necessary to clearly reflect income, as we have indicated above.

Moreover, the cases upon which we chiefly rely, such as *United States v. Lynch*, *supra*, and *Jud Plumbing & Heating v. Commissioner*, *supra*, strongly support the view that hybrid methods may be resorted to where necessary to clearly reflect income and protect the revenue in situations like the one at bar.

Waldheim Realty & Inv. Co. v. Commissioner, 245 F. 2d 823 (C. A. 8th), cited in the *amici* brief (Br. 5), is distinguishable on the facts and represents quite a different taxable situation, irrespective of whether it may be considered as correctly decided.

The *amici curiae* reiterate their contention (Br. 7-8) that it is beyond the power of the Commissioner to require Wendell to include the accrued interest in its final return; and they argue that such inclusion produces a distortion of income, apparently basing their argument mainly upon the untenable proposition that no deviation can ever be made from a strict cash or a strict accrual method (whichever is applicable) and that if there be any such deviation, however slight, then *a fortiori* there must be an ensuing distortion of income to that extent.

This argument of the *amici curiae* is not only at

variance with the established law and practice, but it really assumes the question and does not meet the basic issue as to whether the Commissioner can require a cash basis taxpayer to report accrued income in its final return where such income was earned by it prior to its liquidation and dissolution. Moreover, if not so taxed in the instant case, the income might escape taxation altogether since the distributee in liquidation (taxpayer herein) concededly offset its costs against the amount of interest that it eventually received. (R. 23, 29-30.)

In the circumstances of this case, the accrued income was actually realized by Wendell prior to liquidation, as we have pointed out above, and in such circumstances it make no difference whether Wendell was on the cash or accrual method of accounting. Cf. *Brown v. Commissioner*, *supra*. In either case, Wendell constructively received the amount of this accrued interest as a part of the purchase price for the transferred assets. *Kimbell-Diamond Milling Co. v. Commissioner*, *supra*; *Commissioner v. Ashland Oil & R. Co.*, *supra*; *Estate of Suter v. Commissioner*, *supra*.

And even if there had been no purchase of stock with intention to liquidate and immediately acquire the assets, still, the result would be the same for as pointed out by this Court in the *Lynch* case, *supra*, the fundamental change in the corporation's circumstances, that is, its liquidation and consequent non-existence, prevented its accounting technique from clearly reflecting its income for the short period ending with its liquidation; and a corporate liquidation and transfer of assets cannot divert taxability of income already earned any more than does an assign-

ment of such income.

The *amici curiae* refer (Br. 8-9) to Treasury Regulations 111, Section 29.52-1 (which is substantially the same as Treasury Regulations 118, Section 39.52-1, Appendix A, *infra*, here applicable). This regulation provides that a corporation is not in existence after it ceases business and dissolves, retaining no assets. See *United States v. Loo*, 248 F. 2d 765 (C. A. 9th), certiorari denied, 356 U.S. 928. However, that provision is clearly not at variance with our views and it does not support the extreme contentions of the taxpayer here. It is true that in the *Hess* case, *supra*, this Court reaffirmed its earlier decision in the *Horschel* case, *supra*, and said (210 F. 2d at p. 558) that where shareholders of a fully dissolved corporation receive money or other property which would have been taxable income to the corporation at that time, if the corporation were still in existence, the corporation is not taxable thereon. But in that connection, this Court did not hold nor purport to hold that the Commissioner could not make an allocation of income in a situation like the one at bar so that the amount accrued to date of liquidation will be taxed to the liquidating corporation in its final return regardless of whether it happens to be on the cash or accrual basis. Such an allocation and treatment of interest is supported by and consistent with decisions such as *United States v. Lynch*, *supra*; *Jud Plumbing & Heating v. Commissioner*, *supra*; *United States v. Horschel*, *supra*; *Commissioner v. Henry Hess Co.*, *supra*, none of which is discussed or even cited in the brief of the *amici curiae*. And see 2 Mertens, Law of Federal Income Taxation (1955 ed.) Section 17.17.

The *amici curiae* say (Br. 11) that it is apparent that under any handling of the situation, the entire amount of interest will be reported as a part of the gross income of some taxpayer. But the *amici curiae* do not mention nor discuss the stipulated fact (R. 23, 29-30) that the transferee in the instant case (Idaho First National Bank), although reporting as income the interest when collected, nevertheless offset the collections against the allocated cost, so that all of the amount collected was recovery of cost and not subject to income tax. The method prescribed by the Commissioner would prevent an incongruous result and would achieve the desirable result of taxing the accrued interest to the one (Wendell) who earned it.

As we have indicated above, the *amici curiae* brief makes no effort to reconcile or explain the cases such as *Lynch* and *Jud Plumbing* which are most analogous to the situation at bar, but rather chooses to ignore them. And in the circumstances we can only conclude that the *amici curiae* are asking this Court to depart from the principles for which such cases stand. We submit that there is no adequate basis in the law, the Regulations or the applicable court decisions for any such deviation, and therefore the determination of the District Court herein should be upheld by this Court.

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted,

CHARLES K. RICE,
Assistant Attorney General.

LEE A. JACKSON,

A. F. PRESCOTT,

L. W. POST,

Attorneys,

Department of Justice,
Washington 25, D. C.

BEN PETERSON,
United States Attorney.

KENNETH G. BERGQUIST,
Assistant United States Attorney.

October, 1958

APPENDIX A

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.* — “Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22)

SEC 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SECTION 42. (As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687) PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a difference period. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 42.)

SEC. 45. (As amended by Sec. 128 (b) of the Revenue Act of 1943, c. 63, 58 Stat. 21) ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

(26 U.S.C. 1952 ed., Sec. 45.)

SEC. 47. RETURNS FOR A PERIOD OF LESS

THAN TWELVE MONTHS.

* * * * *

(g) [As added by Sec. 135 (c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Returns Where Taxpayer Not In Existence For Twelve Months.*—

In the case of a taxpayer not in existence during the whole of an annual accounting period ending on the last day of a month, or, if the taxpayer has no such annual accounting period or does not keep books, during the whole of a calendar year, the return shall be made for the fractional part of the year during which the taxpayer was in existence.

(26 U.S.C. 1952 ed., Sec. 47.)

SEC. 48. DEFINITIONS.

When used in this chapter—

(a) [As amended by Sec. 135 (d) of the Revenue Act of 1942, *supra*] *Taxable Year.*—“Taxable year” means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. “Taxable year” means, in the case of a return made for a fractional part of a year under the provisions of this chapter or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made.

* * * * *

(c) “*Paid Or Incurred,*” “*Paid Or Accrued.*”—The terms “paid or incurred” and “paid or accrued” shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

(26 U.S.C. 1952. ed., Sec. 48.)

SEC. 52. CORPORATION RETURNS.

(a) *Requirement.*—Every corporation, subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. * * *

(26 U.S.C. 1952 ed., Sec. 52.)

* * * * *

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

Sec. 39.22 (a)-20. *Gross income of corporation in liquidation.* When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298). Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however, they may have appreciated or depreciated in value since their acquisition. * * *

Sec. 39.41-1. *Computation of net income.* Net

income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 39.42-1 to 39.42-3, inclusive). If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 39.41-2. *Bases of computation and changes in accounting methods.* (a) Approved standard method of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definition of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by

the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. But see sections 42 and 43. See also section 48. For instance, in any case in which it is necessary to use an inventory, no method of accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See sections 39.42.2 and 39.42-3.) On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. * * *

* * * * *

Sec. 39.41-3 *Methods of accounting.* It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. * * *

* * * * *

Sec. 39.52-1. *Corporation returns.* * * *

(b) A corporation having an existence during any portion of a taxable year is required to make a return. If a corporation was not in existence throughout an annual accounting period (either calendar year or fiscal year), the corporation is required to make a return for that fractional part

of a year during which it was in existence. A corporation is not in existence after it ceases business and dissolves, retaining no assets, whether or not under State law it may thereafter be treated as continuing as a corporation for certain limited purposes connected with winding up its affairs, such as for the purpose of suing and being sued. If the corporation has valuable claims for which it will bring suit during this period, it has retained assets, and it continues in existence. * * *

* * * * *

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO
SOUTHERN DIVISION

THE IDAHO FIRST NATIONAL BANK,
Plaintiff,
vs.
UNITED STATES OF AMERICA,
Defendant.
CIVIL NO. 3269

MEMORANDUM OF DECISION

The facts in this suit for refund are stipulated, so that the sole question for decision is one of law.

It is my opinion that the position taken by the Commissioner is warranted by statute and has ample support in the decisions.

Let judgment in favor of the United States be entered accordingly.

WILLIAM HEALY
Acting District Judge

Dated October 4, 1957.

No. 16,004
United States Court of Appeals
For the Ninth Circuit

<p>THE IDAHO FIRST NATIONAL BANK,</p> <p style="text-align: center;">vs.</p> <p>UNITED STATES OF AMERICA,</p>	}	<p style="text-align: right;"><i>Appellant,</i></p> <p style="text-align: right;"><i>Appellee.</i></p>
---	---	--

**Appeal from the United States District Court
for the District of Idaho,
Southern Division.**

REPLY BRIEF OF APPELLANT.

MYRON E. ANDERSON,
Idaho Building, Boise, Idaho,
ANDERSON, KAUFMAN AND ANDERSON,
EUGENE H. ANDERSON,
Idaho Building, Boise, Idaho,
Attorneys for Appellant.

FILED

OCT 30 1958

PAUL P. O'BRIEN; CLERK

Subject Index

	Page
Summary of argument	1
Argument	2
The interest was not realized by Wendell bank	2
Such interest income did not escape taxation	2
Liquidation of Wendell bank, being the event on which commissioner relies, does not justify the commissioner in accruing the interest income to Wendell bank	2
The change sought to be made by the commissioner is not a change of method	4

Table of Cases

	Page
Jud Plumbing and Heating Company v. Commissioner, 153 Fed. 2d 681	4
Standard Paving Company v. Commissioner, 190 Fed. 2d 330	4
United States v. Lynch, 192 Fed. 2d 718	4

REPORT OF THE
COMMISSIONER OF THE GENERAL LAND OFFICE
FOR THE YEAR 1881

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
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81
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83
84
85
86
87
88
89
90
91
92
93
94
95
96
97
98
99
100

No. 16,004

**United States Court of Appeals
For the Ninth Circuit**

THE IDAHO FIRST NATIONAL BANK,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

**Appeal from the United States District Court
for the District of Idaho,
Southern Division.**

REPLY BRIEF OF APPELLANT.

SUMMARY OF ARGUMENT.

The interest was not realized by Wendell bank.

Such interest did not escape taxation.

The liquidation of Wendell bank, being the event on which commissioner relies, does not justify the commissioner in accruing the interest income to Wendell bank.

The change sought to be made by the commissioner is not a change of method.

ARGUMENT.**THE INTEREST WAS NOT REALIZED BY WENDELL BANK.**

Interest accrues by the passage of time. It is earned by a cash basis taxpayer when it is received. In this case Wendell bank did not receive the interest. It did not receive anything for the interest. There was no economic benefit to Wendell bank by the accrual of the interest.

In this case the economic benefit accrued to the former shareholders of Wendell bank in the enhanced value of their stock. Such enhanced value was reflected in the sale price of the stock to the appellant.

SUCH INTEREST INCOME DID NOT ESCAPE TAXATION.

The interest value was taken into consideration in the sale price of the stock of the Wendell shareholders to the appellant. It was reflected in the sale price of the stock and resulted in a capital gains tax to the shareholders.

The interest income was received by the appellant bank as transferee on liquidation. It was income to appellant bank and was reportable, and reported, as income by such transferee.

LIQUIDATION OF WENDELL BANK, BEING THE EVENT ON WHICH THE COMMISSIONER RELIES, DOES NOT JUSTIFY THE COMMISSIONER IN ACCRUING THE INTEREST INCOME TO WENDELL BANK.

Interest income of Wendell bank was a recurring substantial classification of income consistently han-

dled in the accounting system of the bank for many years on a cash receipts and disbursements basis. The interest income sought to be accrued by the commissioner is clearly not income under that method of accounting.

There is no method of accounting which is exact at all times nor absolute in the determination of income. The best that can be obtained from any method of accounting is consistency together with the application of recognized accounting principles.

There should be general rules with respect to methods of accounting recognized by the federal income tax law upon which both the government and the taxpayer may rely, not subject to change at any time it may appear to the commissioner that a change will result in more tax for the government. The rules should not be changed to fit any particular instance. The change sought to be made by the commissioner in this case violates recognized accounting principles.

The acts of the commissioner ignore the principle of consistency and rely upon liquidation as the event which gives rise to the right to make the change. There is no authority in the statute to the commissioner to make a change solely because of liquidation.

The entire argument of the appellee amounts to an urging to the court to approve such broad powers in the commissioner as would authorize the commissioner upon liquidation to make any change in items which would result in the most tax for the government. Appellee's construction of the statute is not that the

commissioner should be given the authority to make changes in accounting methods as would clearly reflect income, but, rather, make changes in items of income or expense, in the books of the corporation, to clearly reflect the greatest possible income.

**THE CHANGE SOUGHT TO BE MADE BY THE COMMISSIONER
IS NOT A CHANGE OF METHOD.**

Here the commissioner seeks to accrue only interest income of a cash basis taxpayer. Such change is being made in a period which also includes income earned in former periods and received in the period disturbed by the commissioner. This results in a distortion of income in the period in which the change has been made. It results in bunching income into such period. The commissioner disregarded items of expense incurred but not paid and not deducted.

The appellee relies chiefly on three cases, namely, *United States v. Lynch*, 192 Fed. 2d 718; *Jud Plumbing and Heating Company v. Commissioner*, 153 Fed. 2d 681, and *Standard Paving Company v. Commissioner*, 190 Fed. 2d 330.

We fail to see any application of the *Lynch* case to the facts here. In the *Lynch* case, the corporation transferred apples as a dividend to its shareholders. There the court held the apples to be a dividend and as such earnings of the corporation and income to the shareholders.

The *Jud* and *Standard Paving* cases appear to us to be identical with each other in principle. It also

appears to us that in each such case there was the distinct flavor of liquidation to escape taxation.

The case before the court does not have that flavor.

Dated, Boise, Idaho,

October 27, 1958.

MYRON E. ANDERSON,
ANDERSON, KAUFMAN AND ANDERSON,
By EUGENE H. ANDERSON,
Attorneys for Appellant.

appears to be that in each case there was the
 distinct favor of liquidation to some extent or
 the other but the latter does not appear to be the

Dated, New York, N.Y.

October 27, 1932

Very truly yours,

By *[Signature]*
 [Name]
 [Title]

No. 16005 ✓

United States
Court of Appeals
for the Ninth Circuit

UNITED STATES OF AMERICA, Appellant,

vs.

OREN E. CUMMINS,

Appellee.

Transcript of Record

Appeal from the United States District Court for the
Southern District of California,
Central Division

FILED

AUG - 4 1958

PAUL P. O'BRIEN, CLERK

No. 16005

United States
Court of Appeals
for the Ninth Circuit

UNITED STATES OF AMERICA, Appellant,

VS.

OREN E. CUMMINS,

Appellee.

Transcript of Record

Appeal from the United States District Court for the
Southern District of California,
Central Division



INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	PAGE
Amended Complaint	9
Answer to Amended Complaint.....	13
Appeal:	
Certificate of Clerk to Transcript of Rec- ord on	30
Notice of	30
Statement of Points on Which Appellant Will Rely on (USCA).....	142
Certificate of Clerk to Transcript of Record...	30
Complaint	3
Complaint, Amended	9
Findings of Fact, Conclusions of Law and Judgment	19
Judgment	29
Motion and Notice of Motion to Dismiss Com- plaint	6
Names and Addresses of Attorneys.....	1
Notice of Appeal.....	30

ii.

Objections to Findings of Fact.....	18
Order on Motions to Dismiss.....	7
Statement of Points on Which Appellant Will Rely (USCA)	142
Transcript of Proceedings and Testimony.....	32
Exhibits for Plaintiff:	
1—Deposition of Paris B. Claypoole....	79-107
Admitted in Evidence.....	38
2—Deposition of Vincent B. Murphy...108-135	
Admitted in Evidence.....	38
3—Letter Dated Oct. 10, 1956, John E. Blann, Board of Appeals and Review to Oren E. Cummins.....	136-137
Admitted in Evidence.....	40
4—Letter Dated May 2, 1955, M. Latham, Jr., Acting Director, Personnel and Training Division, CIR, to O. E. Cum- mins	137-138
Admitted in Evidence.....	41
5—Letter Dated Feb. 7, 1955, M. J. Flat- tery, Chief, Placement Branch, CIR, to Oren E. Cummins.....	139
Admitted in Evidence.....	41
6—Letter Dated Apr. 5, 1955, M. J. Flat- tery to O. E. Cummins.....	140-141
Admitted in Evidence.....	41

Transcript of Proceedings—(Continued):

Exhibits for Plaintiff—(Continued):

7—Copy of Page 8 of Instruction Manual	
—Penalty Cases	141
Admitted in Evidence.....	42

Witnesses for Plaintiff:

Claypoole, Paris B. (Deposition)	
—direct (Mortenson)	79
—cross (Lavine)	89
—cross (Machtinger)	101
—redirect (Mortenson)	105

Cummins, Oren E.	
—direct	43
—cross	59
—redirect	69

Murphy, Vincent B. (Deposition)	
—direct (Mortenson)	108
—cross (Lavine)	118
—cross (Machtinger)	129
—redirect (Mortenson)	130, 134
—recross (Machtinger)	133

Witness for Defendant:

Murphy, Vincent B.	
—direct	71
—cross	72

1999

1. The first part of the document is a letter from the President of the United States to the Congress, dated January 1, 1861. It is a formal address, and it begins with the words "My Countrymen," which is a traditional opening for such a document. The letter discusses the state of the Union at the time and the challenges facing the country.

1977-1978

100

NAMES AND ADDRESSES OF ATTORNEYS

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ROBERT S. GREEN,
Attorneys.
Department of Justice,
Washington 25, D. C.

For Appellee:

ERNEST R. MORTENSON,
961 East Green Street,
Pasadena 2, California. [1]*

* Page numbers appearing at bottom of page of Original Transcript of Record.

**In the District Court of the United States, Southern
District of California, Central Division**

Civil Action No. 18798-T

OREN E. CUMMINS, Plaintiff,

VS.

UNITED STATES, Defendant.

**COMPLAINT FOR DECLARATORY RELIEF,
AND MONEY DAMAGES**

Plaintiff brings this action under the Act of May 29, 1930, 46 Stat. 468; U.S.C., Title 5, Section 691 (d), as amended; also known as Section 1 (d) of the Retirement Act, as amended, for \$760.00 and other relief, and alleges as follows:

1.

Plaintiff is an individual residing at 918 Encanto Drive, Arcadia, California.

2.

Plaintiff retired as an employee of the Internal Revenue Service, Treasury Department of the United States on November 30, 1954.

3.

Plaintiff's duties during employment were primarily the investigation and apprehension of persons suspected or convicted of offences against the criminal laws of the United States.

4.

Plaintiff was more than fifty years of age on November 30, 1954.

5.

Plaintiff on November 30, 1954, had rendered more than twenty years of service in the duty of investigation and apprehension of persons suspected or convicted of offences against the criminal laws of the United States. [2]

6.

The aforesaid services as alleged in par. 5, rendered by the plaintiff constituted a degree of hazard contemplated by Section 1 (d) of the Retirement Act, as amended.

7.

The life annuity of plaintiff has been computed and granted under Section 4 (a) of the Retirement Act, the Treasury Department and Civil Service Commissioner have neglected and refused to allow plaintiff's annuity under Section 1 (d) of the Retirement Act, as amended. Plaintiff has exhausted all administrative remedies through appeals.

8.

That on information and belief, the Civil Service Commission advised the Treasury Department that all time spent in the performance of duties specified in Section 1 (d) of the Retirement Act, and performed jointly with special agents were creditable toward retirement under Section 1 (d) of the Retirement Act, as amended, regardless of the title

of the position held by plaintiff, if such service is documented. During consideration of plaintiff's application for retirement under Section 1 (d) of the Retirement Act, as amended, the personnel branch of the Treasury Department requested from the Audit Division a documentation of cases plaintiff worked jointly with special agents, and that in response thereto Mr. Fellers, Chief, Audit Division, informed the Personnel Division, there was no record of the cases in which plaintiff worked jointly with special agents. During plaintiff's employment, plaintiff submitted, to the Audit Division, regular monthly reports showing all cases being worked jointly with special agents, and said reports are and were available [3] to Mr. Fellers, Chief, Audit Division, for documentation. The Commissioner of Internal Revenue has refused to recommend to the Civil Service Commissioner plaintiff's eligibility for retirement under Section 1 (d) of the Retirement Act, as amended because the Audit Division failed to document the cases plaintiff worked jointly with special agents. Wherefore, plaintiff prays for judgment, ordering defendant to pay to said plaintiff for the remainder of his life an annuity computed under Section 1 (d) of the Retirement Act as amended; and to pay to plaintiff the sum of \$760.00, this being the difference between an annuity computed under Section 1 (d) of the Retirement Act, as amended and an annuity granted and being paid under Section 4 (a) of the Retirement Act, as amended, representing \$76.00 per month for ten months from December 1, 1954, to and including,

September 1955; and to pay to plaintiff an amount of \$82.00 per month from October 1, 1955, until judgment, this being the difference between computation under Section 4 (a) and Section 1 (d) of the Retirement Act under an Act passed by the last Congress and effective as of October 1, 1955, and such other and further relief as this court may deem proper in the premise.

/s/ OREN E. CUMMINS,
Plaintiff.

Dated at Los Angeles Sep. 26, 1955.

Duly Verified. [4]

[Endorsed]: Filed September 26, 1955.

[Title of District Court and Cause.]

MOTION AND NOTICE OF MOTION TO DISMISS COMPLAINT

Notice Is Hereby Given that on February 6, 1956, at 10:00 o'clock A.M., in the Courtroom of the Honorable Ernest A. Tolin, Judge of the above-entitled Court, the United States Attorney will move to dismiss the plaintiff's Complaint.

The grounds for the Motion are as follows:

1. Lack of jurisdiction over the subject matter.
2. Failure to state a claim upon which relief can be granted.

The Motion will be based on the plaintiff's Com-

plaint and on the Memorandum of Points and Authorities attached hereto.

LAUGHLIN E. WATERS,

United States Attorney.

MAX F. DEUTZ,

Assistant U. S. Attorney,

Chief, Civil Division.

/s/ **JOSEPH D. MULLENDER, JR.,**

Assistant U. S. Attorney.

Attorneys for Defendant. [5]

Memorandum of Points and Authorities Attached.

[6-8]

Affidavit of Service by Mail Attached. [9]

[Endorsed]: Filed January 20, 1956.

[Title of District Court and Cause.]

ORDER ON MOTIONS TO DISMISS

The above-entitled cause having come on regularly for hearing on the defendant's Motions to Dismiss on March 5, 1956, at 10:00 o'clock A.M., before the Honorable Ernest A. Tolin, Judge of the above Court;

The plaintiff having appeared by his attorney, Ernest R. Mortenson;

The defendant having appeared by the United States Attorney;

The Court having considered the pleadings filed herein, the arguments of counsel, and being fully advised in the premises;

It Is Hereby Ordered, Adjudged and Decreed:
That the defendant's Motion to Dismiss for fail-

ure to state a claim upon which relief can be granted be and the same is hereby denied;

That the defendant's Motion to Dismiss for a lack of jurisdiction over the subject matter is granted, insofar as the Complaint seeks relief for moneys to become due in the future; [12]

That the plaintiff is granted leave to amend his Complaint to pray for Judgment for all sums which may have accrued up to the the date of Judgment, and that the plaintiff shall have thirty (30) days from March 5, 1956, within which time to file an Amended Complaint;

That the defendant may have sixty (60) days from the date of service of the Amended Complaint within which time to file an Answer.

Dated: This 14th day of March, 1956.

/s/ ERNEST A. TOLIN,
District Judge.

Presented By:

LAUGHLIN E. WATERS,
United States Attorney,
MAX F. DEUTZ,
Assistant U. S. Attorney,
Chief, Civil Division,

/s/ JOSEPH D. MULLENDER, JR.,
Assistant U. S. Attorney,
Attorneys for Defendant.

Approved As To Form: this 9th day of March, 1956.

/s/ ERNEST R. MORTENSON,
Attorney for Plaintiff. [13]

[Endorsed]: Filed March 14, 1956.

[Title of District Court and Cause.]

AMENDED COMPLAINT

Pursuant to order of this Court entered on March 14, 1956, Plaintiff files herein the following amended complaint:

I.

This action is to recover balance due on the retirement annuity of Plaintiff from December 1, 1954 to the date of judgment herein as hereinafter more fully appears. Plaintiff is a citizen of the United States; Plaintiff's claim does not exceed Ten Thousand Dollars (\$10,000.00); and jurisdiction is conferred upon this Court by 28 USC, Section 1,346(a)(2). This suit is further brought for the purpose of obtaining a declaratory judgment, pursuant to 28 USC, Section 2201, that Plaintiff is entitled to retirement as an employee of the Internal Revenue Service, Treasury Department of the United States, under Section 1(d) of the Retirement Act as amended, Civil Service Retirement Act of May 29, 1930, USC, Title 5, Section 691 (d), as amended. [14]

II.

Plaintiff is an individual residing at 918 Encanto Drive, Arcadia, Los Angeles County, California.

III.

Plaintiff's duties during employment were primarily the investigation and apprehension of persons suspected or convicted of offences against the criminal laws of the United States.

IV.

Plaintiff was more than fifty (50) years of age on November 30, 1954.

V.

Plaintiff, on November 30, 1954, had rendered more than twenty (20) years of service in performance of the duties described in Paragraph III above.

VI.

The services described in Paragraph III which were rendered by Plaintiff constituted a degree of hazard encompassed by Section 1(d) of said Retirement Act.

VII.

The life annuity of Plaintiff has been computed and granted under Section 4(a) of the said Retirement Act by the Treasury Department and Civil Service Commission. The Treasury Department and Civil Service Commission, although requested to do so, have neglected and refused to permit plaintiff to retire with the annuity provided under Section 1(d) of said Retirement Act. Plaintiff has exhausted all administrative remedies and appeals. On information and belief the Civil Service Commission has advised the Treasury Department that all time spent in the performance of duties described in Section 1(d) of said Retirement Act and performed jointly with Special Agents were creditable toward retirement under Section 1(d) of said Retirement Act regardless of the title of the position held by Plaintiff, [15] provided such serv-

ices were documented. During the course of Plaintiff's application for retirement under Section 1(d) of said Retirement Act, the Personnel Branch of the Treasury Department requested from the Audit Division a documentation of cases Plaintiff worked jointly with Special Agents. In response thereto, Mr. Fellers, Chief, Audit Division, informed the Personnel Branch there was no record of the cases which Plaintiff jointly worked with Special Agents. During the period of Plaintiff's employment, Plaintiff submitted to the Audit Division regular monthly reports showing all cases being worked jointly with Special Agents and said reports were and are available to the Audit Division and other departments of the Treasury Department for documentation.

VIII.

The Commissioner of Internal Revenue has failed and refused to recommend to the Civil Service Commission that Plaintiff be retired under Section 1(d) of said Retirement Act and the Civil Service Commission has failed and refused to retire Plaintiff under Section 1(d) of said Retirement Act, contrary to the provisions of said Retirement Act.

Wherefore, Plaintiff prays for judgment ordering Defendant to pay to Plaintiff the sum of Seven Hundred Sixty Dollars (\$760.00), representing Seventy-six Dollars (\$76.00) per month for the ten months from December 1, 1954 to and including September of 1955, and in addition thereto to pay to Plaintiff an amount of Eighty-two Dollars

(\$82.00) per month from October 1, 1955 until the date of judgment herein. The said monthly sums of Seventy-six Dollars (\$76.00) and Eighty-two Dollars (\$82.00), respectively, represent the difference between computation under Section 4(a) and Section 1(d) of said Retirement Act. An amendment to said Retirement Act, passed at the last session of Congress and effective as of October 1, 1955, increases the differential between Plaintiff's monthly retirement annuity under Sections 4(a) and 1(d) from Seventy-six [16] Dollars (\$76.00) to Eighty-two Dollars (\$82.00).

Plaintiff further prays for judgment declaring and adjudging the Plaintiff is entitled to be retired under Section 1(d) of the Civil Service Retirement Act of May 29, 1930, as amended, and for such other and further relief as this Court may deem just and proper.

Dated: April 2, 1956.

/s/ ERNEST R. MORTENSON,
Attorney for Plaintiff. [17]

Duly Verified. [18]

[Endorsed]: Filed April 3, 1956.

[Title of District Court and Cause.]

ANSWER

Comes now the defendant, United States of America, and files this Answer to the Plaintiff's First Amended Complaint.

I.

Answering Paragraph I of the First Amended Complaint, defendant:

Admits that this action is to recover the balance due on a retirement annuity from December 1, 1954, to date of Judgment;

Admits that plaintiff is a citizen of the United States;

Denies that plaintiff's claim does not exceed \$10,000.00, and alleges that the District Court does not have jurisdiction to allow plaintiff's claim in an amount exceeding \$10,000.00;

Admits that jurisdiction is conferred upon this Court by 28 U.S.C.A. 1346(a)(2);

Admits that this suit is further brought for the purpose of obtaining a Declaratory Judgment, pursuant to 28 U.S.C.A. 2201, but denies that this Statute enlarges the jurisdiction of the [19] District Court, which is limited to \$10,000.00, as provided in 28 U.S.C.A. 1346(a)(2);

Admits that plaintiff is entitled to retirement as an employee of the Internal Revenue Service, but denies that he is entitled to retirement under Section 1(d) of the Retirement Act, as amended, Civil

Service Retirement Act of May 29, 1930, U.S.C. Title 5, Section 691(d), as amended.

Except as herein expressly admitted, each and all of the remaining allegations of Paragraph I of the First Amended Complaint are both generally and specifically denied.

II.

Answering Paragraph II of the First Amended Complaint, defendant admits all of the allegations therein contained.

III.

Answering Paragraph III of the First Amended Complaint, defendant denies both generally and specifically each and all of the allegations therein contained, and denies that the plaintiff's duties during employment were primarily the investigation and apprehension of persons suspected or convicted of offenses against the criminal laws of the United States.

IV.

Answering Paragraph IV of the First Amended Complaint, defendant admits all of the allegations therein contained.

V.

Answering Paragraph V of the First Amended Complaint, defendant admits that on November 30, 1954, the plaintiff had rendered more than twenty (20) years of service with the Internal Revenue Department, but denies that plaintiff's duties were such as those described in Paragraph III of the First Amended Complaint. Except as herein expressly admitted, each and all of the allegations of

Paragraph V of the First Amended Complaint are both generally and specifically denied. [20]

VI.

Answering Paragraph VI of the First Amended Complaint, defendant denies both generally and specifically each and all of the allegations therein contained; denies that the services described in Paragraph III of the First Amended Complaint were rendered by the plaintiff, and denies that the services described in Paragraph III of the First Amended Complaint or the services rendered by the plaintiff constituted a degree of hazard encompassed by Section 1(d) of the Retirement Act.

VII.

Answering Paragraph VII of the First Amended Complaint, defendant:

Admits that the life annuity of the plaintiff has been computed and granted under Section 4(a) of the Retirement Act, that the plaintiff requested retirement under Section 1(d) of the Act, and that the plaintiff's request was refused;

Alleges that the circumstances under which the plaintiff was denied retirement under Section 1(d) of the Act are as follows:

On November 4, 1954, the Acting District Director of Internal Revenue at Los Angeles, Harold Hawkins, wrote to the Regional Commissioner of Internal Revenue at San Francisco, California, and requested a determination of the plaintiff's eligibility for retirement under Section 1(d). With the

letter were enclosed the plaintiff's application for retirement, statements from the Chief of the Audit Division, and the plaintiff's group supervisor and plaintiff's personnel folder.

On November 12, 1954, the Chief of the Personnel Branch of the Regional Commissioner's Office, W. J. DeWeese, replied to the letter of November 4, 1954, and advised that the plaintiff was not eligible for retirement under Section 1(d). The reason given was that from an examination of the plaintiff's employment records it appeared that his duties were not primarily the investigation, [21] apprehension or detention of persons suspected or convicted of offenses against the criminal laws of the United States, but that his duties consisted primarily of examining books and records of tax payers to determine tax liability.

On November 17, 1954, the Chief of the Personnel Branch of the Los Angeles Office, Robert D. Hogan, wrote to the Regional Commissioner and requested that the plaintiff's application be forwarded to the National Office for final decision.

On November 23, 1954, W. J. DeWeese forwarded the plaintiff's application to the Assistant Commissioner, Administration, in Washington, D. C., and asked for a decision as to the plaintiff's eligibility for retirement under Section 1(d).

On December 3, 1954, the Chief of the Placement Branch in Washington, D. C., M. J. Flattery, replied to W. J. DeWeese's letter, and advised that the plaintiff was not eligible for retirement under Section 1(d). The reason given was that although

the Civil Service Commission had informally advised the Treasury Department that all time spent in the performance of specified duties may be creditable toward retirement under Section 1(d) of the Retirement Act, regardless of the title of the position, Mr. Fellers, Chief, Audit Division, had stated that there was no record of the cases which the plaintiff worked jointly with Special Agents, and no record of the degree of hazards; that since plaintiff did not occupy a position approved for inclusion under Section 1(d) of the Civil Service Retirement Act, he was not, in any case, eligible to have his retirement annuity computed under its provisions.

Except as herein expressly admitted, each and all of the remaining allegations of Paragraph VII of the First Amended Complaint are both generally and specifically denied.

VIII.

Answering Paragraph VIII of the First Amended Complaint, defendant: [22]

Admits that the Commissioner of Internal Revenue has failed and refused to recommend to the Civil Service Commission that plaintiff be retired under Section 1(d) of the Retirement Act, and that the Civil Service Commission has failed and refused to retire plaintiff under Section 1(d) of said Retirement Act;

Denies that such failure or refusal is contrary to the provisions of said Retirement Act;

Alleges that the plaintiff is not entitled to retirement under Section 1(d) of the Retirement Act.

Wherefore, defendant prays for a Judgment against the plaintiff as follows:

1. That the plaintiff take nothing by virtue of his First Amended Complaint;
2. For costs of suit, and such other relief as may be proper.

LAUGHLIN E. WATERS,
United States Attorney,
MAX F. DEUTZ,
Assistant U. S. Attorney,
Chief, Civil Division,

/s/ JOSEPH D. MULLENDER,
JR.,
Assistant U. S. Attorney,
Attorneys for Defendant. [23]

Affidavit of Service by Mail Attached. [24]

[Endorsed]: Filed July 2, 1956.

[Title of District Court and Cause.]

OBJECTIONS TO FINDINGS OF FACT

Comes now the defendant, United States of America, and objects to Findings of Fact No. 7 as set forth in the proposed Findings of Fact lodged with the District Court on or about December 11, 1957.

Such objection is on the ground that the record of the trial is devoid of any evidence that plaintiff

was subjected to any degree of hazard whatsoever.

Dated: December 13, 1957.

LAUGHLIN E. WATERS,
United States Attorney,
RICHARD A. LAVINE,
Assistant U. S. Attorney,
Chief of Civil Division,
/s/ RICHARD A. LAVINE,
Attorneys for Defendant. [76]

Affidavit of Service by Mail Attached. [77]

[Endorsed]: Filed December 13, 1957.

In the District Court of the United States, South-
ern District of California, Central Division

No. 18798-T

OREN E. CUMMINS, Plaintiff,

vs.

UNITED STATES OF AMERICA, Defendant.

FINDINGS OF FACT, CONCLUSIONS
OF LAW AND JUDGMENT

The above entitled case having been duly set for argument on November 22, 1957 before the Honorable Ernest A. Tolin, Judge, presiding, Ernest R. Mortenson appearing as counsel for Plaintiff, Laughlin E. Waters, United States Attorney, Max F. Deutz, Assistant United States Attorney, Richard A. Lavine, Assistant United States Attorney,

appearing as counsel for Defendant, United States of America.

Evidence having been taken and arguments of counsel having been heard, the Court hereby makes the following:

Findings of Fact

1.

The Plaintiff, Oren E. Cummins, a resident of California, was an Internal Revenue Agent from March 26, 1928 to November 30, 1954. [78]

2.

On October 1, 1928, Plaintiff was assigned to what is known as the "Fraud Group" and his duties were to make joint investigations with Special Agents of the Intelligence Division of persons suspected or convicted of offenses against the criminal laws of the United States. Plaintiff performed such duties from that date until November 30, 1954, the date of his retirement.

3.

On November 30, 1954, Plaintiff had reached the age of 70 years. During performance of his duties Plaintiff conducted many joint investigations of so-called "racketeers" suspected of having committed crimes against the Internal Revenue laws of the United States.

4.

In all cases in which a joint investigation of possible tax violations was conducted by Plaintiff and a Special Agent, where the Special Agent recommended prosecution of the taxpayer Plaintiff sub-

mitted a report of his investigation to accompany the Special Agent's recommendation.

5.

The following instructions were issued to Internal Revenue Agents charged with the duty of investigating fraud cases:

“Penalty Cases”

“Especially in fraud cases the investigation should be thorough and complete in every detail and the examining officer should arm himself with knowledge of every phase of the case for the further reason that he should be prepared to be an intelligent witness for the Government in the event of subsequent litigation, either in a civil trial before the Board of Tax Appeals in connection with the determination of penalty liability or in a criminal trial before the United States Federal Courts.

page -8-”

6.

Under Rules and Regulations in force during Plaintiff's [79] tenure, a Special Agent could not recommend prosecution for tax evasion without an accompanying report of the Internal Revenue Agent who investigated the case jointly with such Special Agent.

7.

In the performance of his duties, Plaintiff was subjected to a degree of hazard as great as or greater than the degree of hazard to which the Spe-

cial Agent with whom he conducted the joint investigation was subjected.

8.

On October 18, 1954, Plaintiff made application for retirement under Section 691(d) of Title 5 USCA (Section 1(d)) and submitted certain information in support of his eligibility for retirement under said Section. The application was rejected.

9.

On May 2, 1955 the Secretary of the Treasury by his delegate, informed Plaintiff as follows:

“You have no appeal to the Civil Service Commission since retirement under Section 1(d) must be recommended by the head of the agency. It is not a right to which an employee becomes entitled by virtue of specific services but is discretionary with the Secretary of the Treasury.

Your case has received careful consideration but evidence has not been presented to conclusively prove that you performed the duties of a Special Agent, which is a position approved for coverage under Section 1(d). Therefore, we have no basis for ruling favorably on your appeal.”

10.

On February 7, 1955 the Secretary of the Treasury by his delegate, informed Plaintiff as follows:

“This refers to your letter concerning your eligibility for retirement under Section 1(d) of the Retirement Act.

The Treasury Department negotiated with the

Civil Service Commission a list of positions approved for inclusion under Section 1(d). The duties of such positions had to be within the scope of standards furnished by the Civil Service Commission. The position of Internal Revenue Agent, GS-512, in the Audit Division [80] has not been approved for coverage; the position of Special Agent (Tax Fraud), GS-1811, in the Intelligence Division is, however, covered.

As you requested, I am enclosing a list of the positions which have been approved by the Civil Service Commission."

11.

The list of positions approved by the Civil Service Commission for retirement under Section 1(d) is as follows:

"Internal Revenue Service
Positions Covered by Section 1(d),
Retirement Act

Alcohol and Tobacco Tax Division:

National Office: Director, Alcohol & Tobacco Tax Division, Chief, Enforcement Branch, Assistant Chief, Enforcement Branch, Technical Advisor, Examiner (Enforcement), Chief, Raw Materials Section.

Field Office: Assistant Regional Commissioner (if eligible because of prior enforcement service), Chief, Enforcement Branch, Supervisor in Charge (Enforcement), Special Investigator, Investigator (all positions designated by the CSC as Criminal Investigators).

Intelligence Division:

National Office: Director, Intelligence Division, Assistant Director, Intelligence Division.

Field Office: (if eligible because of prior enforcement service), Regional Commissioner, Assistant Regional Commissioner, District Director & Assistant District Director, Executive Assistant to ARC, Int., Technical Advisor, Chief, Intelligence Division, Assistant Chief, Intelligence Div., Chief of Branch, Group Supervisor, Senior Internal Revenue Agent (Special Agent), Principal Internal Revenue Agent (Special Agent), Internal Revenue Agent (Special Agent).

Inspection Service:

Group Supervisor and Criminal Assignment Squad, New York (6 in the 1811 Series). In order to be eligible, employee must retire from a covered position." [81]

12.

In a letter dated April 5, 1955, the Secretary of the Treasury by his delegate, informed Plaintiff as follows:

"It is mandatory that an employee occupy a position approved for coverage under Section 1(d) at the time he retires in order to have his annuity computed under its provisions. If an employee occupying a covered position needs time spent on detail from an uncovered position to a covered position to make up the necessary twenty years, such time spent on detail is creditable if properly documented.

Since the position of Internal Revenue Agent, which you occupied at the time you retired, is not approved for inclusion under Section 1(d), you are not, in any case, eligible to have your retirement annuity computed under the provisions of this Section. I am sorry, but we are unable to take any action in your case."

13.

In a letter dated March 2, 1955 the Civil Service Commission informed Plaintiff as follows:

'The office of the Regional Commissioner for the Internal Revenue Service informs us that at the time of your retirement you were not occupying a position which was approved for inclusion under Section 1(d) of the Retirement Act, and that no recommendation could therefore be made for your retirement under this Section.

Under the circumstances there is no authority for your retirement under Section 1(d) of the Retirement Act."

14.

The Secretary of the Treasury refused to recommend Plaintiff's Retirement under Section 1(d) on the ground that Plaintiff was ineligible because at the time of his retirement, he was not classified in a position approved for inclusion under section 1(d).

15.

In refusing recommendation of Plaintiff's retirement under Section 1(d), the Secretary of the Treasury did not consider the type of duties per-

formed by Plaintiff individually nor the degree of hazard to which he was individually subjected in the performance of his duties. [82]

16.

The Secretary of the Treasury in denying Plaintiff retirement under Section 1(d) gave consideration to the general duties of the class of position held by Plaintiff.

17.

The Secretary of the Treasury refused to recommend retirement of Plaintiff under Section 1(d) because of an erroneous interpretation of said Section.

18.

Although advised that Plaintiff had applied for retirement under Section 1(d), the Civil Service Commission failed to determine whether plaintiff was entitled to retirement under Section 1(d).

19.

The Civil Service Commission did not give consideration to the degree of hazard to which plaintiff was individually subjected in the performance of his duties.

20.

The Civil Service Commission gave consideration to the general duties of the class of the positions held by Plaintiff.

21.

The Civil Service Commission negotiated a list of positions covered by Section 1(d) because of an erroneous interpretation of said Section.

22.

At the date of his retirement, Plaintiff was more than 50 years of age and had rendered more than 20 years of service in a position, the duties of which were primarily the investigation of persons suspected or convicted of offenses against the criminal laws of the United States and the service actually performed was of such a nature.

23.

Plaintiff in the performance of his duties was subjected to [83] a degree of hazard contemplated by Section 1(d).

24.

All conclusions of law which are or are deemed to be Findings of Fact are hereby found as facts and are incorporated herein as Findings of Fact.

Conclusions of Law

1.

This Court has no jurisdiction to entertain an action for declaratory relief against the United States to determine whether Plaintiff is entitled to certain benefits under Section 691(d) of Title 5, USCA.

2.

This Court has jurisdiction over the action for money judgment pursuant to the provisions of the Tucker Act, 28 USCA Section 1346(a)(2).

3.

Plaintiff at the time of his application for retirement had satisfied all of the requirements for re-

tirement under Section 691(d) of Title 5, USCA and is entitled to have his annuity computed under said Section.

4.

In rejecting a proposed bill based upon position classification and in enacting Section 691(d), which provides, in part, "In making such determination, the Commission shall give full consideration to the degree of hazard to which such officer or employee is subjected in the performance of his duties rather than the general duties of the class of the position held by such officer or employee," the Congress intended that each application for retirement should be considered on its merits without regard to the particular title of the position held.

5.

The failure of the Secretary of the Treasury and the [84] Civil Service Commission to grant Plaintiff's retirement under Section 691(d) was due to an erroneous interpretation of said Section in that the refusal of such retirement was based upon a classification of positions which had been set up contrary to the provisions of said Section.

6.

Plaintiff has exhausted his administrative remedies.

7.

All Findings of Fact which are or are deemed to be conclusions of law are hereby incorporated in these conclusions of law.

Judgment

In accordance with the foregoing Findings of Fact and Conclusions of Law, it is hereby ordered, adjudged and decreed:

That Plaintiff is entitled to money judgment in the sum of Seven Hundred Sixty Dollars (\$760.00); that Defendant shall take nothing in the action; that Plaintiff is hereby awarded costs of suit in the amount of \$.

Dated: This 13th day of December, 1957.

/s/ ERNEST A. TOLIN,
United States District Judge.

Defendants objections filed December 13, 1957 have been considered.

/s/ ERNEST A. TOLIN,
Judge. [85]

[Endorsed]: Filed and Entered December 13, 1957.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that Defendant United States of America hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on December 13, 1957.

Dated: February 6, 1958.

LAUGHLIN E. WATERS,
United States Attorney,
RICHARD A. LAVINE,
Assistant U. S. Attorney,
Chief of Civil Division,
/s/ RICHARD A. LAVINE,
Assistant U. S. Attorney,
Attorneys for Defendant. [87]

Affidavit of Service by Mail Attached. [88]

[Endorsed]: Filed February 6, 1958.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled matter:

A. The foregoing pages numbered 1 to 92, inclusive, containing the original:

Complaint.

Motion and Notice of Motion to Dismiss.

Appearance of Ernest R. Mortensen as attorney for plaintiff.

Order on Motions to Dismiss.

Amended Complaint.

Answer.

Defendant's Trial Memorandum.

Supplement to Defendant's Trial Memorandum.

Plaintiff's Trial Memorandum.

Defendant's Second Supplemental Memorandum.

Objections to Findings of Fact.

Findings of Fact, Conclusions of Law and Judgment.

Notice of Appeal.

Application for extension of time for filing and docketing record on Appeal and Order thereon.

Designation of Record on Appeal.

B. Minute Order of 3/5/56 re hearing on motion to dismiss.

Minute Order of 10/22/56 re trial.

Minute Order of 11/22/57 re Oral argument.

C. Plaintiff's Exhibits 1 to 10, inclusive.

Defendant's Exhibits A to F, inclusive.

D. One volume of Reporter's Official Transcript of Proceedings had on: October 22, 1956.

I further certify that my fee for preparing the foregoing record, amounting to \$1.60, has not been paid by appellant.

Dated: May 6, 1958.

[Seal] JOHN A. CHILDRESS,
Clerk,

s/ By WM. A. WHITE,
Deputy Clerk.

In The United States District Court, Southern
District of California, Central Division

No. 18,798-T

OREN E. CUMMINS, Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

REPORTER'S TRANSCRIPT OF
PROCEEDINGS

Los Angeles, California
October 22, 1956

Honorable Ernest A. Tolin, Judge Presiding.

Appearances: For the Plaintiff: Ernest R. Mortenson, 961 East Green Street, Pasadena, California. For the Defendant: Laughlin E. Waters, United States Attorney, By: Richard A. Lavine, Assistant United States Attorney, 600 Federal Building, Los Angeles, California, and Sidney J. Machtinger, Special Attorney, Internal Revenue Service. [1]*

Monday, October 22, 1956. 1:30 P.M.

The Court: Call our case.

The Clerk: 18,798-T, Oren E. Cummins, v. United States of America, for trial.

* Page numbers appearing at top of page of Reporter's Transcript of Record.

Mr. Mortenson: Ready for the plaintiff.

The Court: Mr. Mortenson, the court was impressed with the possibility that administrative remedies have not been exhausted. That seems to have a little more emphasis when we received the Government's supplemental memoranda the latter part of last week. What about that?

Mr. Mortenson: The situation is quite interesting, your Honor. In the file sent the United States Attorney by the Civil Service Commission there was omitted a letter addressed to Mr. O. E. Cummins, 918 Encanto Drive, Arcadia, California, dated May 2, 1955, in which the statement was made:

"Your final appeal is to the Director of Personnel, Treasury Department."

However, despite the fact that the plaintiff had been misled by the Treasury Department itself as to what his remedies were, subsequent to the filing of the memorandum of points and authorities by the defendant I wired the Civil Service Commission, stating that I wished to appeal under the section cited by the defendant, and I have a reply dated October 10, 1956, in which it is stated that the " * * * the [3] decision reached by the Retirement Division in your case is affirmed."

So that this final step has now been taken and the Civil Service Commission itself has affirmed the action of the Retirement Division. I shall offer this in evidence.

Mr. Lavine: Counsel is quite correct. We withdraw our point on that subject.

The Court: I have been bothered in this case by the fact that the fixing of the two per cent shall be on the recommendation of somebody. Is that recommendation a mere ministerial thing or is it one which must follow automatically from the existence of a certain set of facts, or does it involve an element of discretion?

Mr. Mortenson: My interpretation of that provision is that it is primarily ministerial. In my brief I pointed out the fact that at least one Congressional committee thought that it was compulsory for the Secretary of the Treasury to make the recommendation, if the retired person fit within the provisions of the code section.

However, the Dismuke case in the Supreme Court, and the Anderson case in the Ninth Circuit, I believe, are pretty clear on this point, that if the action of the Treasury Department is arbitrary or capricious the court does have jurisdiction, and I believe the cases also clearly hold if there had been a misrepresentation of the law on the part of [4] the Treasury Department, then the court has jurisdiction.

The Court: The exercise of that jurisdiction, though, can only lead us to perform an action that is before this court now, to the rendition of a money judgment. Who exercises the discretion which has been misexercised under your theory by the official who should have made the recommendation?

Mr. Mortenson: Well, if it is a question of mandatory or, rather, the declaratory judgment

part of the complaint, I would like to withdraw that and just leave the prayer for a money judgment.

Now, it is because of the error in interpretation of law by the Treasury Department that the plaintiff here is entitled to a money judgment.

The Court: Of course, the Government comes here and says, "This isn't a matter of a particular class of employee. It is a matter of right, being entitled to two per cent instead of one and one-half." It says, "The employee acquires that right if he has a particular recommendation," and the theory back of the recommendation is that it will bring about the earlier retirement of men who are past the vigorous age which is apparently necessary to subdue these persons who are subject to investigation in criminal cases. It involves, if the Government is right, rather an appraisal of the staff as a whole, than of the particular person whose retirement is in contemplation. And if that is what is to be considered or [5] if those are the things to be considered, I don't know how a court sitting here can appraise those matters.

Mr. Mortenson: I think, your Honor, that argument would have some force if we had a situation where a person requesting retirement for some particular reason should not be retired under that section. For example, if the employee were then under charges of some kind, I should think it would be within the discretion of the department head to refuse to recommend that the person be retired.

But in this case there has been no explanation

of any kind as to why retirement under this section should be refused, except a legal one. There are only two legal reasons given, and that is clear from the Civil Service file.

Reason No. 1, the title which this plaintiff bears is not one which is included in a list promulgated by the Treasury Department for inclusion in retirement under Section 1(d). I went into the history of that in my brief, and I think it is very clear that Congress never intended that any department of the Government should put out lists or should use classifications as a basis for determining eligibility. So that there was an error of law. I believe there the Treasury Department has clearly misinterpreted or misapplied this provision of the Civil Service Code.

Then the next objection that was given was that the plaintiff could not be retired under this section because his [6] work was not primarily that of investigating persons suspected of crimes against the United States. Now, that was put in terms of generality, and not that this particular plaintiff or individual didn't meet the requirements. It is that that class of individuals did not meet the requirements of the Code and, therefore, it becomes——

The Court: They took the view, didn't they, that the class of employment in which this plaintiff was classified was one which dealt primarily with accounting, and that that was not the investigation of persons suspected of crime?

Mr. Mortenson: That is basically the Govern-

ment's position, and that is the principal point which I believe this court is authorized and obligated to settle.

The Court: Tell me, has it been settled for us on a District Court level, at least, by some one of the other cases of this character which have been filed here?

Mr. Mortenson: The Anderson and the Dismuke cases are similar in some respects, but, as far as I know, this is the first plaintiff in the United States who was a member of a fraud squad—I believe the evidence is going to show there are only four or, at the most, six fraud groups in the United States, and in those groups only a small percentage would qualify.

The Court: What happened in the Gibney case?

Mr. Mortenson: The Gibney case is set for trial the 30th [7] of this month before Judge Yankwich.

The Court: I thought perhaps we would have the benefit of a Yankwich opinion by the time this case came up for trial, and that is what I was fishing for. But now that we have had our little colloquy, let's try the case. You try it in your way.

I was merely undertaking to point out to you some of the factors of the case, questions of the case which have particularly seemed to present some difficulty from my reading of the file.

Mr. Mortenson: I take it from your questions that you have read the briefs, so I don't believe that it will be necessary to make any statement about the issues in the case. It might facilitate

matters if we entered the documentary evidence at this point. I believe Government counsel and I are agreed on what should go in.

The Court: All right.

Mr. Mortenson: There are two depositions which have been filed, one of Vincent B. Murphy, presently group supervisor of the fraud group, who has an office in this building, and a deposition of Paris Claypoole, who formerly occupied that position. I should like to offer those at this time.

Mr. Lavine: No objection.

The Court: Received.

(The documents referred to were marked Plaintiff's Exhibits 1 and 2, and were received in evidence.) [8]

[See pages 79-135]

Mr. Mortenson: There is a file which is in the hands of the Assistant United States Attorney, Mr. Lavine, that——

Mr. Lavine: With your permission.

Mr. Mortenson: ——might go in at this time, except there is one problem in connection with that. One of the exhibits contains a list of taxpayers who were subject to a fraud investigation, some of whom were not tried for tax evasion. We thought, as a matter of procedure, it might be advisable to have that list sealed by the court and then reference to it could just be made generally, if that procedure is agreeable.

Mr. Lavine: I would suggest it be stipulated, with the approval of the court, such list only be available to the clerk, this court and the trial

judge of the court, and be sealed and used thereafter, only upon retrial or appeal proceedings, if that is agreeable.

The Court: You are suggesting an in camera inspection of the list?

Mr. Lavine: Yes.

Mr. Mortenson: Yes.

The Court: It is agreeable to the court.

Mr. Lavine: Mr. Mortenson, I suggest we offer the administrative file, less the confidential exhibit, as Defendant's Exhibit A, which includes documents forwarded to us by the Department of the Treasury and the Civil Service Commission. [9]

As Defendant's Exhibit B I have placed in an envelope a list of cases prepared by the plaintiff in this action, which purports to be a list of some two hundred or so cases worked on by him as an internal revenue agent, involving suspected fraud cases, during the course of 27 years.

The Court: The exhibits offered are received.

(The document referred to were marked Defendant's Exhibits A and B, and were received in evidence.)

The Court: When you say "suspected fraud cases", are you referring to cases in which persons were suspected of civil fraud only, or how are you using the term "fraud"?

Mr. Mortenson: Criminal fraud. In all cases there was a suspicion that the taxpayer had been engaged in some criminal tax evasion.

Mr. Lavine: That is likewise the sense in which I used the word "fraud", your Honor.

The Court: All right.

Mr. Mortenson: A few of those exhibits have not been copied for my file, your Honor. Will it be necessary to get a court order to have copies made?

The Court: I think they are just available to you. You can copy them or have your secretary come in and make copies. The court record will be available, except for that Exhibit B of the defendant's, which I understand is restricted to my view. [10]

Mr. Lavine: By my stipulation I meant to include, also, counsel for plaintiff, who is well aware of the contents.

The Court: All right. Well, it will be available to your use then. I take it the object is to prevent the use of names here as persons who had been suspected of criminal action when it was administratively decided that the facts did not warrant prosecution.

Mr. Mortenson: That is correct, your Honor.

As Plaintiff's Exhibit 3 I should like to offer a letter dated October 10, 1956, addressed to the plaintiff by John E. Blann, Chairman of the Board of Appeals and Review.

The Court: Received.

(The document referred to was marked Plaintiff's Exhibit 3 and was received in evidence.)

[See pages 136-137]

Mr. Mortenson: As Plaintiff's Exhibit 4, a letter addressed to the plaintiff, dated May 2, 1955,

signed by M. Latham, Jr., Acting Director, Personnel and Training Division.

The Court: Received.

(The document referred to was marked Plaintiff's Exhibit 4 and was received in evidence.)

[See pages 137-138.]

Mr. Mortenson: As Plaintiff's Exhibit 5, a letter dated February 7, 1955, addressed to the plaintiff by Mr. M. J. Flattery, Chief, Placement Branch.

The Court: Received.

(The document referred to was marked Plaintiff's Exhibit 5 and was received in evidence.) [11]

[See page 139]

Mr. Mortenson: Plaintiff's Exhibit 6, a letter dated April 5, 1955, addressed to the plaintiff by Mr. Flattery.

The Court: Received.

(The document referred to was marked Plaintiff's Exhibit 6 and was received in evidence.)

[See pages 140-141]

Mr. Mortenson: As Plaintiff's Exhibit 7, I would like to offer an excerpt from an instruction manual entitled "Penalty Cases", prepared by the Special Adjustment Section, Income Tax Unit, April, 1935. The excerpt appears at page 8.

The Court: Received.

(The document referred to was marked

Plaintiff's Exhibit 7 and was received in evidence.)

[See page 141]

The Court: I take it, Mr. Mortenson, that upon these facts which you are now establishing or expect to establish by this and what other evidence you bring in, the court would be compelled to find there was only one way in which the discretion could be exercised?

Mr. Mortenson: I should like to make that statement. When I used the word "compelled" I meant to say I thought the court would be compelled to make a decision. It had jurisdiction, and it would be an issue of law on which the court would be compelled to make a decision. In other words, it is not the class of case where an administrative officer has used his discretion in determining what action should be taken on a particular set of facts. I believe there will be no factual [12] dispute in this case.

The Court: Well, suppose that the administrative officer has reached his administrative decision on a misconception of the law. He thought he should use one standard when he actually should have used another? Do we then use the standard he should have used? Would it not be more proper—but certainly not under this state of pleadings—for us to send it back to him and say, "Now, this is the standard you should have used. Go ahead and use it"? The sort of thing that might arise upon a suit based upon one of the extraordinary writs, for instance.

But in an action for money damages we can't do that. We either exercise his administration for him, we apply the standard he should have applied and find it adds up to a different rule than the arbitrary standard which he improperly applied, or we just substitute our judgment for his, or we find that he had no place in it except the performance of a ministerial act, that under these facts there is no possibility for anything except a determination that the two per cent should have been used instead of the one and a half.

Mr. Mortenson: Well, I would like to stand on two grounds. One is that this is purely a question of law, particularly related to the use of the word "primarily".

But I believe I have an alternate ground, and, that is, the action was arbitrary. [13]

The Court: But how could we tell it would have reached a different result if it had been considered in a judicious instead of a capricious and arbitrary manner?

Mr. Mortenson: I would be very happy for a decision in my favor on either ground.

Mr. Cummins, will you take the stand, please?

OREN E. CUMMINS

the plaintiff herein, called as a witness in his own behalf, having been first duly sworn, was examined and testified as follows:

Direct Examination

Q. (By Mr. Mortenson): Mr. Cummins, would you state your full name?

(Testimony of Oren E. Cummins.)

A. Oren E. Cummins.

Q. Is this your first appearance in the federal court, Mr. Cummins?

A. No, it is not; there have been many.

Q. Could you estimate the number of days you have been a witness in federal court in an official capacity?

A. In an official capacity?

Q. As a government agent.

A. Somewhere between a thousand and three thousand days.

Q. What is your present occupation, Mr. Cummins?

A. Public accountant.

Q. What was your occupation before you became a public [14] accountant?

A. Internal Revenue agent.

Q. When did you leave the employ of the Government as an internal revenue agent?

A. November 30, 1954.

Q. When did you begin service as an internal revenue agent?

A. I entered the Service March 26, 1928.

Q. At the time that you were so appointed, were you given a specific assignment?

A. No, I was not.

Q. What did you do when you first became an agent?

A. The time I became an agent, up till October 1st, 1928, I was assigned with another internal revenue agent for the purpose of instruction and learning how to be an internal revenue agent.

Q. And after that assignment, what happened?

(Testimony of Oren E. Cummins.)

A. On October 1st, 1928, I was assigned to what is known as the fraud group, Los Angeles Division.

Q. At that time was a letter written with respect to your assignment? A. Yes.

Q. I show you a document which is part of Defendant's Exhibit A, bearing the date October 1, 1928, addressed to you and signed by S. S. Stahl, and ask you whether that is the [15] letter to which you refer.

A. That is a photostat of the original letter which I have. No, I beg your pardon. It is not. That is a photostat of a typed copy of the original.

Q. Do you have the original? A. Yes, I do.

Q. Is this an accurate copy of the original?

A. With the exception of the signature of S. S. Stahl.

Mr. Mortenson: Very well. May we have this read at this time, your Honor?

The Court: Yes.

Q. (By Mr. Mortenson): Would you read that letter? Just read the body of it, please.

A. (Reading) "Due to the accumulation of work being handled jointly with the Intelligence Unit, it has become necessary to assign additional agents to assist in this work for an indefinite period.

"You have been selected as one to assist. Please get in touch with Internal Revenue Agent Warner E. Williams at your earliest convenience and arrange to work under his direct supervision until

(Testimony of Oren E. Cummins.)

released from that class of cases. As soon as this joint work is brought up to date, your services will again be utilized by your regular Group Chief, but during this assignment he will be relieved of all [16] supervision over your work."

The Court: What was the date of that?

The Witness: October 1, 1928. That is the time I had completed training.

The Court: Did you receive it at or about that time?

The Witness: No, I received it at that time.

Q. (By Mr. Mortenson): Will you state what accounting and legal training you have had, Mr. Cummins?

A. I am a graduate from the Kansas State University of Accounting. I took a course with a higher accounting firm in Los Angeles, whose name is Racine.

Q. Was it the Racine Institute of Accounting?

A. Racine Institute of Accounting, that is correct. And I finished a course of law with Blackstone University, from which I received an LL.D.

Q. That was an LL.B.? A. LL.B.

Q. That was a correspondence course, was it?

A. That is correct.

Q. Do you know, Mr. Cummins, or have you been advised as to the number of fraud groups that exist in the United States at the present time?

A. I do not know, except from observation and what I have been told there were. I do know for a certainty with respect to a couple of divisions,

(Testimony of Oren E. Cummins.)

that Chicago had a fraud [17] division at the time I went to Chicago one time on one of my cases. Seattle had a fraud division. I understand that New York had a fraud group. I believe there was one in Texas; I believe it was Dallas, I am not sure. Probably one in—I have had information there is one in Cincinnati.

Q. That is, there probably are not more than six fraud groups in the United States at this time?

A. I believe that would be correct, yes.

Q. As to the number of individuals in these fraud groups who might in any way satisfy the requirement of Section 1(d), you say the number would be under 100?

A. Oh, yes, I believe they would be much under 100.

Q. At the time of your retirement, did you apply specifically for retirement under Section 1 (d)?

A. I did.

Q. Without referring specifically to your own experience, what are the respective duties of a revenue agent and a special agent who work jointly on a fraud case? By that I mean a criminal tax fraud case.

A. Did you want me to outline the duties of each or the difference between them?

Q. I think if you would just state generally the duties of each, then we could make the comparison.

A. Well, to begin with, cases in which criminal evasion of income tax is involved, the cases arise

(Testimony of Oren E. Cummins.)

from two sources. [18] One is in the revenue agent's office and another in the special agent's office.

Years ago, the early years of high service, if it originated in the special agent's office it would be forwarded to the internal revenue agent's office and all cases there were assigned to the group that handled the fraud work. And the group supervisor would assign these cases to the various men under his supervision. All these cases so assigned—most all of them contained an information of some sort, some bookkeeper of a taxpayer or some friend or someone who stated that this particular taxpayer had been evading his income tax by this and by that method. After the case was assigned the revenue agent would proceed to investigate these charges. After the investigation had proceeded to a point where the revenue agent felt in his own mind that a criminal evasion of the income tax had been committed, it was his duty to call upon a special agent for cooperation in the case. At this point the special agent would join the revenue agent in the investigation, and the two agents would work together, both within the taxpayer's office, outside securing witnesses or any evidence that might be necessary to sustain the evasion case.

After evidence or information regarding the case had been gathered, it was the duty of the revenue agent to write his report. This report consisted of two separate reports. One we called a techni-

(Testimony of Oren E. Cummins.)

cal report, in which a computation was [19] made of net income, tax and penalties, if any were involved.

A second report, which was known as a confidential report, in which all evidence of whatever nature may have been gathered, was assembled, and in this report any statements that the taxpayer may have made that might be detrimental to him or evidence secured from witnesses other than the taxpayer, copies of books and records and bank accounts were all submitted in this confidential report.

At the end of this report we made our recommendation. This report—these two reports, after being typed, were sent to the special agent's office, after which they wrote their report and made their recommendations.

Q. In general, was this the procedure followed during the whole period during which you were an internal revenue agent? A. Yes.

Q. Under the rules and regulations in force during that period, was it possible to have a criminal tax evasion case without a revenue agent or deputy collector being assigned to the case?

A. No, I do not believe it would be possible; no.

Q. What is one essential that would be part of the revenue agent's work and part of the revenue agent's report, which would preclude the special agent from turning a case over for prosecution?

A. It would be the auditing feature and the writing of what we called the technical report,

(Testimony of Oren E. Cummins.)

which was a computation of income, taxes and penalties.

Q. In a joint investigation for tax fraud during the period of your tenure did a special agent have authority to order you to do any particular act?

A. He did not.

Q. Did the special agent with whom you worked have any disciplinary control over you?

A. No.

Q. In whom did supervisory and disciplinary powers rest insofar as you were concerned?

A. To the internal revenue agent in charge, through my group supervisor.

Q. And in the case of the special agent who cooperated with you in the investigation, who had supervisory powers over him?

A. The group—the special agent in charge, through the group supervisor in his office.

Q. In the actual conduct of an investigation of a tax evasion case, is there or was there a division between the criminal aspects of the case and the non-criminal aspects?

A. None that I could ever observe.

Q. Would you explain what those words mean as they have been used in various courts? I will withdraw that question. [21]

Did you ever investigate a criminal tax case in which you had practically completed the investigation before you referred the matter to the Intelligence Division?

A. Yes, I have.

Q. In such a case, what would the function of the special agent be who was assigned to that case?

(Testimony of Oren E. Cummins.)

A. Well, I don't know what his functions might be. I know what they do.

Q. Tell us what——

A. They take the revenue agent's report and follow it and make their recommendations. That doesn't happen very often.

I would like to explain in particular with respect to one case which might clear up the reason for such cases evolving. I had a case a number of years ago which the taxpayer or corporation claimed on the return a loss of \$80,000.00. I had to finish that case before I knew whether I could overcome the \$80,000.00 loss and set up a tax. That was the reason that a special agent would not be called in until the case was completed. And in this case a fraud penalty was asserted and the special agent recommended criminal prosecution. I have forgotten whether I recommended criminal or not. I have recommended criminal in many cases.

Mr. Mortenson: May I use this confidential list, your Honor, to show to the witness? [22]

The Court: Yes.

Q. (By Mr. Mortenson): Mr. Cummins, I show you a list of names under dates, and ask you whether that is a list which you yourself prepared. A. It is.

Q. This is a list of taxpayers that were investigated by you for possible crime against the internal revenue laws of the United States, is that correct? A. That is correct.

(Testimony of Oren E. Cummins.)

Q. I show you a newspaper clipping which carries in the top left-hand corner a picture, under which is the name "Sol Zemansky". Does that name appear on your list? A. It does.

Mr. Mortenson: I should like to offer this into evidence as the Plaintiff's next in order.

The Court: Received.

The Clerk: Plaintiff's 8.

(The document referred to was marked Plaintiff's Exhibit 8 and was received in evidence.)

Q. (By Mr. Mortenson): I show you another newspaper clipping bearing the heading "U. S. Suit on McAfee Perturbs Politicians", and ask you whether that refers to a case which you investigated. A. It does. It is on this list.

Mr. Mortenson: I would like to offer this as the Plaintiff's [23] next in order.

The Court: Received.

The Clerk: Plaintiff's 9.

(The document referred to was marked Plaintiff's Exhibit 9 and was received in evidence.)

Q. (By Mr. Mortenson): On this list which you hold in your hand, are there names listed of individuals that were considered to be racketeers and questionable characters?

A. Yes, on this list, from the year 1931 to 1941 everyone, with the exception of one, is considered racketeers, gamblers, and there are others in other

(Testimony of Oren E. Cummins.)

years, but those ten years I worked practically nothing except racketeers.

Q. Mr. Cummins, what proportion of your time, from your appointment to the fraud squad in 1928 to the date of your retirement November 30, 1954, was devoted to investigation of taxpayers who were suspected of crimes against the United States?

A. All my time with the exception of perhaps a year or 18 months.

Q. As between the revenue agent and the special agent who worked a joint fraud investigation, which one is likely to spend more time with the taxpayer's associates and employees?

A. The revenue agent spends much more time.

Q. During the period of your employment did you keep a count of the hours and days spent on fraud work? [24]

A. Yes, I did.

Q. In the ordinary fraud case, during your tenure, who would be most likely to first contact the taxpayer, the revenue agent or the special agent?

A. The revenue agent.

Q. Mr. Cummins, I show you a copy which bears the legend "Internal Revenue Service Positions Covered By Section 1(d), Retirement Act", and ask you whether that is a copy of a list you received from the Treasury Department accompanying a letter dated February 7, 1955, signed by M. J. Flattery, Chief, Placement Branch.

A. It is.

Mr. Mortenson: This is offered as Plaintiff's No.—

(Testimony of Oren E. Cummins.)

The Clerk: 10.

The Court: Received.

(The document referred to was marked Plaintiff's Exhibit 10 and was received in evidence.)

Q. (By Mr. Mortenson): In your experience in investigating criminal fraud cases, Mr. Cummins, would you say that you were exposed to danger as much as or less than a special agent with whom you worked?

A. I would say more than, because we spent more time with the taxpayer and employees.

Q. With respect to the so-called racketeers whom you investigated, would that statement apply? [25] A. Yes.

Q. Did you ever investigate a criminal tax case in which there was a double set of books?

A. Yes.

Q. Who audited the books?

A. I audited them.

Q. Did the special agent assigned to that case have any part in the auditing of those books?

A. He never saw the books.

Q. In a criminal tax fraud investigation, where admissions were made by the taxpayer, what was done insofar as your activities were concerned with respect to those admissions?

A. They were pointed out in my report. Usually any admissions or statements were taken under oath from a taxpayer, and they would be included as an exhibit within my report.

(Testimony of Oren E. Cummins.)

Q. Were there cases where damaging or incriminating admissions had been made by taxpayers to you? A. Yes.

Q. And in those cases was it also your practice to include a report of such admissions in your revenue agent's report? A. Yes.

Q. Did you testify in court concerning your audit and admissions made by the taxpayer? [26]

A. Many times, both criminal and civil.

Q. Did you investigate a number of cases in Phoenix, Arizona? A. I did.

Q. In one of those cases did you testify at length for the Government?

A. I was on the witness stand for the Government two weeks.

Q. Two weeks? A. Yes.

Q. Now, in that particular case did the special agent testify?

A. He was on the stand and answered one question.

Q. During your experience as a government internal revenue agent in these criminal fraud cases, with respect to the ones which went to trial, did you spend more time on the witness stand as a witness than all of the special agents you worked with combined, or less time?

A. I spent much more time. As a matter of fact, I only recall two of my cases in which a special agent appeared as a witness in a criminal.

Q. Do you recall that you previously stated that it was your practice to make a recommenda-

(Testimony of Oren E. Cummins.)

tion for or against criminal prosecution in the cases which you investigated?

A. I never did make a recommendation against criminal [27] prosecution. I have made many recommendations for criminal prosecutions. If I didn't think the Government had a good case I would not recommend criminal prosecution because I didn't want to have the special agent quarrel with me and say it should have been recommended otherwise, so I left it open.

Mr. Mortenson: You may cross-examine.

Mr. Lavine: Prior to cross-examining, your Honor, may I ask the court's permission to introduce a few documents through Mr. Machtinger, who is regional counsel of Internal Revenue in this area.

The Court: Yes. You mean he is going to start trying the case?

Mr. Lavine: No.

The Court: You represent the Government?

Mr. Machtinger: I will merely introduce the documents. I think I am more familiar with the documents than Mr. Lavine.

The Court: Are you then taking the position of a witness here?

Mr. Machtinger: No, I am entered as co-counsel for the defendant.

Mr. Lavine: Your Honor, I don't believe there is any objection to these exhibits from counsel.

The Court: Are you an Assistant United States Attorney?

(Testimony of Oren E. Cummins.)

Mr. Machtinger: No, sir, I am an attorney admitted to practice in the State of California, an attorney for the [28] Internal Revenue Service.

Mr. Mortenson: I have no objection, your Honor, to Mr. Machtinger appearing here. I don't mean to intrude on your province, but I will be very happy to have him take part in the trial.

The Court: All right, we will allow him to take part, although it is most irregular.

Mr. Mortenson: Personally I have been in the same situation, as you know, your Honor, and I have a great deal of sympathy for this technical approach. As a matter of fact, I think there was a time when you yourself argued that counsel in the chief counsel's office should be permitted to take part in the trial of cases.

The Court: Yes, but I was usually overruled in presenting such argument. I find, in allowing this participation today, I am considerably among the minority among the judges of the court. We will permit it.

Mr. Machtinger: Thank you, sir.

I would like to offer as Defendant's Exhibit next in order a document which is entitled "Procedure With Respect To Income Tax Fraud Cases", which is dated January 30, 1936, and designated as "Commissioner's Mimeograph Collection No. 4418."

The Court: Received.

Mr. Machtinger: The purpose of offering this document is to set forth the procedure that was in effect on January, I [29] believe I said 30th. It

(Testimony of Oren E. Cummins.)

is January 20th, 1936, and years subsequent to that.

The Court: You might show what the prescribed procedure was, what the book procedure was. It will be admitted and you can argue its effect when the time comes for argument.

The Clerk: Defendant's Exhibit C.

(The document referred to was marked Defendant's Exhibit C and was received in evidence.)

Mr. Machtinger: I would like to offer as Government's Exhibit next in order a document entitled "Procedure With Respect To Income Tax Fraud Cases", dated September 18, 1937, bearing "Commissioner's Mimeograph Collection No. 4653." This mimeograph, your Honor, amended the prior one, and the penciled notations on the Government's exhibit offered prior to this one incorporate the provisions of this mimeograph now being offered.

The Court: Received.

The Clerk: Defendant's D.

(The document referred to was marked Defendant's Exhibit D and was received in evidence.)

Mr. Machtinger: As Defendant's E, I offer as Government's exhibit a document bearing Paragraph No. 9322 from the Internal Revenue Manual dated October 3, 1955. This is entitled "Fraud Cases Initiated In Audit and Collection Divisions

(Testimony of Oren E. Cummins.)

Indications of Fraud Reported to Intelligence Division." [30]

The Court: Received.

The Clerk: Defendant's Exhibit E.

(The document referred to was marked Defendant's Exhibit E and was received in evidence.)

Cross Examination

Q. (By Mr. Lavine): Mr. Cummins, in your various cases in which you have worked on fraud aspects of income tax cases, have you always worked with a special agent before the case was concluded?

A. No, I have not.

Q. Let us say that a case was referred to the regional counsel, or whatever the procedure was in 1927 on. In other words, it was recommended by someone for criminal prosecution.

In those cases which fit that category in which you have taken part, has there been any case in which the recommendation for criminal prosecution has been made by somebody, in which you took part, in which there was not a special agent took part?

A. I don't know of any. That was a matter of procedure. It was necessary a special agent be assigned.

Q. Mr. Cummins, I show you Defendant's Exhibit C, which purports to be a regulation dated January 20, 1936, and I direct your attention to the next to the last paragraph on the bottom of that first page. Will you kindly read that?

(Testimony of Oren E. Cummins.)

A. "Investigations Internal Revenue Agents In Charge——" [31]

Q. You can read it to yourself. I will ask you questions on it in a moment.

A. Oh. (Witness complies.)

I have read it.

Q. The first sentence of the paragraph to which I directed your attention reads as follows:

"If during an income tax investigation an internal revenue agent finds what he believes to be indications of fraud, he will immediately suspend his investigation and report his findings in writing to the Internal Revenue Agent in charge, who will forward a copy to the Special Agent in charge."

Was that procedure followed by you at all times, let's say, from 1936 on to 1954?

A. I did not fall within that classification. I was an internal revenue agent, fraud group. This applied to field agents, not to persons working fraud cases.

Q. Do I understand there was some other regulation that was applicable to your——

A. I don't know of any other regulation, but the procedure was different. If it was a fraud agent that discovered fraud he didn't go through this procedure. He simply asked for a special agent.

Q. Let's go to the second sentence there:

"If the Internal Revenue Agent in Charge [32] concludes that the findings indicate probable fraud, he will promptly advise the appropriate Special

(Testimony of Oren E. Cummins.)

Agent in Charge of such findings and request his consideration whether the facts are such as to indicate the necessity for a joint investigation."

Was that procedure followed in the cases investigated by you?

A. Not with respect to the fraud group.

Q. What was the procedure followed by you?

A. With respect to this last paragraph you read, instead of the internal revenue agent referring it to the internal revenue agent in charge, the field agent referred matters to the fraud group investigator, who in turn either supervised the investigation under that agent up to the point when a special agent was called, or took it away from the field agent and gave it to one assigned to the fraud group who was familiar with the procedure.

Q. Let's turn over to page 2, if you will. Will you kindly read that first paragraph at the top of page 2?

A. (Witness complies.) I have read it.

Q. That first sentence states:

"During a joint investigation of an income tax fraud case the Internal Revenue Agent will be responsible for the audit features of the case and the development of evidence necessary to sustain the fraud penalty." [33]

Was that the procedure followed by you and those that worked with you? A. Yes.

Q. It was the responsibility, I understanding, that the internal revenue agent, which is you, for the audit features——

(Testimony of Oren E. Cummins.)

A. Not only the audit features. It doesn't confine it to the audit features.

Q. What more were you responsible for, Mr. Cummins?

A. All evidence necessary to support the audit features, which also supports the criminal.

Q. I read you the third sentence of the same paragraph, which reads:

"The Special Agent will be responsible for the criminal feature of the case."

Do I understand that your procedure was different than set forth in this regulation?

A. I wouldn't say that either agent was responsible for criminal liability. All either agent did was to make recommendations. There was no responsibility of the special agent other than to make his recommendations after he wrote his report, and jointly work with the agent, or the agent jointly work with him, whichever way you put it.

Q. In answer to a previous question you stated these regulations were not applicable to your particular fraud group. [34]

A. I said that with respect to the first part of the first paragraph.

Q. That part is not applicable. I have asked you questions as to Paragraph 1 on page 2. Are those sentences applicable to the duties of you in your work on the fraud squad? A. Yes.

Q. The only part that you object to then is the first two sentences in the paragraph from the bot-

(Testimony of Oren E. Cummins.)

tom of page 1, which begin, "If during an income tax * * * "? Do I so understand your testimony?

A. The paragraph, "If during an income tax investigation an Internal Revenue Agent finds what he believes to be indications of fraud, he will immediately suspend his investigation and report his findings in writing to the Internal Revenue Agent in Charge, who will forward a copy to the special Agent in Charge."

That was not the procedure in the group squad.

Q. Could you tell us who set forth the procedure which you should follow as a member of the fraud squad?

A. Internal revenue agent in charge.

Q. The internal revenue agent in charge set forth the procedure you should follow. Was this in writing or orally?

A. I don't know. It came to me through the group supervisor.

Q. The group supervisor told you what to do and you [35] were told to do it in a certain way.

A. I don't know that he told me what to do. We just did that, that is all; that is the way we work it. What the authority is I am not going to argue, because this is what we did.

Q. You testified, Mr. Cummins, that in your opinion you were in a greater danger than that of a special agent that may be assigned to the case. Have you ever been assaulted? A. No, sir.

Q. In the performance of your duties.

(Testimony of Oren E. Cummins.)

A. No, sir.

Q. Have you known of any other internal revenue agent who has been assaulted, criminally assaulted in the performance of his duties?

A. Neither internal revenue agent nor special agent.

Q. Did you at any time carry a gun in the performance of your duties? A. No, sir.

Q. Were you authorized, permitted to carry a gun in the performance of your duties?

A. I was not prohibited from carrying a gun.

Q. It wasn't part of the paraphernalia you are supposed to carry as an internal revenue agent?

A. No, I was supposed to carry a briefcase and get evidence. [36]

Q. Have you ever been present at any arrest in the performance of your duties? A. No.

Q. Have you been present when any search warrants were served in the performance of your duties?

A. That is the duty of the Collector of Internal Revenue.

Q. You have not been present when such were served? A. Yes, I have.

Q. You have? A. Yes.

Q. Who were they served by?

A. Deputy Collector.

Q. Deputy Collector of Internal Revenue?

A. Deputy Collector.

The Court: Have you ever acted as guard for a witness or anything of that kind?

(Testimony of Oren E. Cummins.)

The Witness: No. I acted as a guard for Japanese property, but not as a witness.

Q. (By Mr. Lavine): Have you ever been present when any structure was broken into by officers of the law in the performance of your duties?

A. No, sir.

Q. Have you been present when structures were entered subject to a search warrant? [37]

A. Yes.

Q. What type of case was that?

A. Jeopardy assessments.

Q. Jeopardy claims?

A. Jeopardy assessments.

The Court: I was assuming that your question was simply unfortunate, because federal agents don't go around breaking into places. They search with search warrants and proceed according to the Constitution.

Q. (By Mr. Lavine): Until the development of a fraud case in which there has been a recommendation made for criminal prosecution, is not part of the processing of the case done by the regional counsel's office of the Internal Revenue Service?

A. Well, after the report of the internal revenue agent and the special agent, I believe the report goes to that—to the regional counsel.

Q. In the conduct of your cases, have you ever known an instance in which the regional offices or members of the regional counsel's office have taken part by interviewing witnesses?

A. Yes.

(Testimony of Oren E. Cummins.)

Q. By examining documentary and other evidence that is necessary for the development of the case? A. Yes.

Q. Now, let's suppose a case has gotten over [38] into the hands of the U. S. Attorney and his assistants. Have you ever known a case in which you were involved in which the United States Attorney or an Assistant United States Attorney has gone out and interviewed witnesses in the development of a case?

A. No, I haven't. They usually call on either the special agent or the revenue agent to do the footwork.

Q. Have you ever heard of a case in which the U. S. Attorney or Assistant U. S. Attorney has gone out and interviewed witnesses or examined documentary evidence? A. No.

Q. Have you ever had occasion to shadow a suspect, a person who was suspected of violating one of the internal revenue laws?

Q. What type of case was that?

Mr. Mortenson: I don't think this witness knows what the word "shadow" means; at least I don't. I object to the form of the question.

The Court: You mean he is not familiar with the words common to the art or the vocation?

The Witness: I understand the meaning of the word "surveillance".

The Court: Let's use the loftier language, counsel.

Q. (By Mr. Lavine): Have you ever taken part in the surveillance of a person or witness suspected of criminal activity? [39]

(Testimony of Oren E. Cummins.)

A. I have, but not with anyone else.

Q. Would you explain the circumstances in which that act occurred?

A. The taxpayer evaded me. I left word at his office a number of times to leave his books for my examination, and he would not. He would not see me. I knew he was giving a lecture at a certain place on a certain hour, at a certain auditorium. I went out there at 9:00 o'clock at night and waited for him, to serve a summons.

The Court: Waited for him to serve a summons?

The Witness: Waited for him, to serve a summons on him, and I caught him.

Q. (By Mr. Lavine): Other than that one instance, have you ever had occasion to use surveillance on a suspect?

A. No, that is the only time.

The Court: Well, have you known of persons holding the same rank as yourself being engaged in the work of surveillance of suspects or witnesses?

The Witness: Yes.

Q. (By Mr. Lavine): Would you describe the circumstances?

A. I wouldn't know the circumstances, only from hearsay.

Q. Isn't that the job of the special agent, to go out and pick up—I should say exercise surveillance over criminal suspects?

A. I think that is the job of the Bureau of [40] Investigation, not the special agent.

(Testimony of Oren E. Cummins.)

Q. Do I understand your answer is that the Federal Bureau of Investigation has any jurisdiction over crimes against the Internal Revenue Code?

A. You didn't say of the Internal Revenue Code——

Q. I will limit my question to that. If so, would your answer to my question be any different?

Mr. Mortenson: Would you mind reading that question?

Mr. Lavine: The only thing—I will reframe the question in the interest of simplicity.

Q. (By Mr. Lavine): Other than the instance which you have quoted, have you ever known of any other internal revenue agent who has exercised surveillance upon any person suspected of violation of the internal revenue laws?

A. Yes, I have.

Q. Would you describe that?

A. It happened—I think of another case I did——

Q. Will you describe——

A. ——in conjunction with a special agent.

Q. What were the circumstances?

A. Working on a case down in New Orleans, Governor of Louisiana, there were about 20 agents and 20 special agents and the Governor had about 30 gum shoes out watching us, and we made it part of our business to watch them.

The Court: What is a "gum shoe"? [41]

The Witness: Detectives.

(Testimony of Oren E. Cummins.)

Q. (By Mr. Lavine): Isn't it a fact, Mr. Cummins, in the investigation of an income tax evasion case, that the principal part of your duties consist in, A, auditing of books; B, verification of various supporting documents, such as bank vouchers, statements, other items which would verify the entries in the taxpayer's books, and all other documentary evidence you can find? Is that not a fact?

A. Well, this other documentary evidence that I might find, what limit do you put on that, if any?

Q. I asked—I used the word in its broadest sense, documentary evidence of all kinds.

A. That was our duty, yes.

Mr. Lavine: No further questions.

Redirect Examination

Q. (By Mr. Mortenson): Mr. Cummins, during your tenure as an internal revenue agent on how many occasions did the special agent, who was in the joint investigation, carry firearms?

A. I never knew of a special agent carrying firearms on duty.

Q. Did you have anything to do with firearms when you were an internal revenue agent?

A. No. I used to go down in the basement of the Federal Building and practice revolver shooting, the same as the [42] special agents did.

Q. In the basement of this building?

A. Yes.

Q. You practiced pistol shooting, is that correct? A. Yes.

(Testimony of Oren E. Cummins.)

Q. You do know how to shoot a gun, don't you, Mr. Cummins? A. Yes, I do; I have one.

Q. With regard to the criminal and the non-criminal features of a tax case, what ordinarily is used to prove the element of criminal intent?

A. The accounting features are the principal evidence in most cases, either net worth or an analysis of the books and other evidence to support it.

Q. Have you been in cases where a criminal intent was proved primarily by documentary evidence? A. Yes.

Mr. Mortenson: No further questions.

Mr. Lavine: No further questions.

(Witness excused.)

Mr. Mortenson: Plaintiff rests.

Mr. Lavine: As Defendant's next in order I would like to introduce the "Tasks and Performance Requirements Statement" for Grades 11, 12 and 13 of an internal revenue agent of the Audit Division. [43]

The Court: Received.

The Clerk: Defendant's F.

(The document referred to was marked Defendant's Exhibit F and was received in evidence.)

Mr. Lavine: I will call Mr. Vincent Murphy.

The Court: How long do you expect to be?

Mr. Lavine: About five minutes.

The Court: All right.

VINCENT B. MURPHY

called as a witness on behalf of the defendant, having been first duly sworn, was examined and testified as follows:

The Clerk: Your name, sir?

The Witness: Vincent B. Murphy.

Direct Examination

Q. (By Mr. Lavine): Mr. Murphy, what is your occupation or profession?

A. I am an internal revenue agent, supervising a group.

Q. Does your group have any special title, popular title?

A. It is Group No. 7 of fraud investigations only.

Q. For how long have you been supervisor of this fraud group?

A. Since November 2, 1949.

Q. In the work of the fraud group of which you are the supervisor, if during a tax investigation an internal revenue [44] agent should find what he believes to be indications of fraud, what is then supposed to be done, according to regulations?

A. In this division, where we have a special fraud group, the regular agent in the field might find fraud and he would submit an information report to the fraud group and we would try to develop it further before we would call in the special agent for joint investigation.

Q. Supposing a fraud case has developed within your group, what does the internal revenue agent

(Testimony of Vincent B. Murphy.)

assigned to your group do once he has found what he definitely suspects to be fraud?

A. He will request cooperation of the special agents.

Q. Do I understand that until that is acted upon favorably or unfavorably he will suspend his activities?

A. Those are his orders.

Mr. Lavine: No further questions.

Cross Examination

Q. (By Mr. Mortenson): Mr. Murphy, do you happen to know when this particular set of instructions marked Defendant's Exhibit F went into effect, approximately the time?

A. Well, this is the test and performance requirements for the regular field audit group. I think it has been in effect, oh, for a number of years, although it has just been [45] recently put on the new form.

Q. It seems to bear a date of '54 at the bottom of the page. Does that mean this particular one was printed up in 1954?

A. That is right. But in addition to this, the fraud agents have further tests and performance requirements.

Q. Was it your understanding, Mr. Murphy, that the general instructions to internal revenue agents with respect to fraud cases were to be modified to the extent it was necessary for you to operate your fraud group in Los Angeles—I am re-

(Testimony of Vincent B. Murphy.)

ferring specifically to this statement on Defendant's Exhibit C:

"If during an income tax investigation an Internal Revenue Agent finds what he believes to be indications of fraud, he will immediately suspend his investigation and report his findings in writing to the Internal Revenue Agent in Charge, who will forward a copy to the Special Agent in Charge."

Was that procedure in Los Angeles during the time that you were group supervisor of the fraud squad? A. Yes, sir, it was.

Q. I thought that you had stated that the revenue agent made a report to you as group supervisor. Was that through the internal revenue agent in charge? A. That is right. [46]

Q. So that what this really means is the report was made to the internal revenue agent in charge to assign the matter to you, is that correct?

A. That is right. We made a further preliminary investigation to see whether we should call in the special agent.

Mr. Mortenson: That is all.

Mr. Lavine: No further questions.

(Witness excused.)

Mr. Lavine: Defendant rests.

The Court: Anything further from the plaintiff?

Mr. Mortenson: Not unless you have some further questions. I would like to present as much of my oral argument today as would help enlighten the court.

The Court: The court would like to become acquainted with a considerable mass of exhibits. I take it one is the administrative file, isn't it?

Mr. Mortenson: Yes, your Honor.

The Court: Before hearing the oral argument, that is. I ought to know the evidence before I hear the argument. Don't you think that would be a prudent procedure?

Mr. Mortenson: Are you going to set a date then for further——

The Court: Yes, it has come in so fast and I haven't had an opportunity to keep current on it. The trial commenced at 1:30 and you have put in quite a bit here, and I take it, [47] from the looks of it, there are at least several dozen pages and I think the court should be entirely familiar with those before hearing the argument. I know your lawsuit involves but a few dollars in this present suit. But it might become *res judicata* so as to affect a great deal of future payments to the plaintiff. I think it would be prudent to put the case over for argument until the court has had opportunity to read these exhibits.

Mr. Mortenson: I think the court may take judicial notice of the fact that in 1956 an amendment to the Retirement Act was passed, which now provides for retirement at two per cent for regular internal revenue agents.

The Court: Then you really are fighting over the seven hundred some-odd dollars.

Mr. Mortenson: As applied to less than a hundred, perhaps less than fifty.

The Court: As applied to this plaintiff.

Mr. Mortenson: It is a very small amount, so far as the Government is concerned. It is very big as far as he is concerned, your Honor.

What I was trying to say was that if he had not retired until now he would get this same two per cent that is in issue at this time.

The Court: Still don't you think that it would be prudent, considering the somewhat vague status of the legal [48] questions here, if the court were fully informed as to the contents of the exhibits before undertaking to follow your argument upon it?

Mr. Mortenson: Yes. I would like to come back for oral argument at any time which you would care to set now or on notice.

Mr. Lavine: That is quite agreeable.

Mr. Machtinger: In connection with Mr. Mortenson's statement about the amendment to the Retirement Act, the important point I think your Honor is putting his finger on is that this case may be res judicata to those other employees permitted to retire at age 50.

The Court: It couldn't be, they are not parties to the suit. It would be res judicata as to this plaintiff's rights concerning future payments. We have jurisdiction here, as I understand it, to only determine what is due up to the time of the filing of the complaint, and if I make a determination of what formula is to be used, I think that would be res judicata as to all payments thereafter to be made to this plaintiff.

Mr. Mortenson: I feel sure that the general accounting office would act upon your judgment and would pay in accordance with it in the future.

The Court: They haven't always done so.

Mr. Mortenson: We wouldn't have to bring a number of [49] suits.

The Court: Well, how long should we wait here before having the oral argument? The evidence, the oral evidence heard today will not be difficult for the court to retain in memory, because it has simply recited, in the specific instance of Mr. Cummins, what has been known to those in this type of government work to be true as to many employees of his class. So I will not have difficulty in retaining a present recollection of the oral testimony. But I would like time to read these various documents.

How long do you think I should have, bearing in mind I do not read them after 10:00 o'clock in the evening?

Mr. Mortenson: I much prefer to have you read these in the fresh part of the morning, your Honor. I can come back any time it suits your convenience.

The Court: When is that other case involving this point going to be tried?

Mr. Lavine: October 30th, your Honor, next Tuesday.

Mr. Mortenson: I think that Judge Yankwich, with his administrative duties as well as the trial of cases, would appreciate your contribution to this particular problem, your Honor.

The Court: I think that it would probably be

better if we had the senior judge's expression first. They don't do that in the appellate courts. They make the youngest one [50] speak out first. But here I think we will let the senior judge decide his case first, and perhaps we can pick up some wisdom from his remarks.

Suppose we argue this case on the 9th of November? Is that all right? It is a Friday.

Mr. Mortenson: Yes, that is agreeable to the plaintiff.

Mr. Lavine: Yes.

The Court: 10:00 o'clock. November 9th at 10:00 o'clock. We will not expect any briefing. If you wish to put in a brief, either of you, it will be read.

Mr. Mortenson: If it is just a matter of the money judgment, then I don't think I will submit any further brief on the matter.

The Court: What bothers me actually is the jurisdiction of the court to render any kind of a judgment here, other than dismissal for want of jurisdiction. It seems to me, just on the first reading of the law, that the jurisdiction here is in the Civil Service Commission and not in the District Court.

Mr. Mortenson: Well, I think that reading of the Dismuke and Anderson cases will dispel any doubt in your mind. Those cases have been cited dozens of times with approval.

The Court: The unfortunate thing about my coming to the bench not prepared on that today is that your brief didn't reach me until Saturday morning. I have not had an opportunity [51] to

read the cases cited therein. I have read the brief, but not the cases.

Mr. Mortenson: Mr. Lavine, I believe, was in Fresno the early part of last week, when I was ready to discuss the matter with him. I felt that I should go over it with him before I filed my brief. When he got back I just had time to get the brief ready and get it filed.

The Court: It is just one of those things that necessitates our putting the case over a little further. I want to read those cases, as well as the exhibits, before coming to a decision.

The case is continued to the 9th of November at 10:00 o'clock for argument, with an option to either of you to provide any further reading matter which you feel might be of assistance to the court.

(Whereupon, at 3:15 o'clock p.m., Monday, October 22, 1956, an adjournment was taken to Friday, November 9, 1956, at 10:00 o'clock a.m.) [52]

[Endorsed]: Filed May 2, 1958.

PLAINTIFF'S EXHIBIT No. 1

[Title of District Court and Cause.]

DEPOSITION OF PARIS B. CLAYPOOLE
taken on behalf of the plaintiff, at Room 625, Federal Building, Los Angeles, California, commencing at 4:00 o'clock p.m. Wednesday, October 10, 1956, before Charles C. Jenkins, CSR, Notary Public, pursuant to the annexed Stipulation.

Appearances of Counsel: For the Plaintiff: Ernest R. Mortenson, Esq. For the Defendant: Laughlin E. Waters, United States Attorney, Max E. Deutz, Assistant United States Attorney, Chief of Civil Division, by Richard A. Lavine, Assistant U. S. Attorney, and Sidney J. Machtinger, Special Attorney, Internal Revenue Service. [1]*

PARIS B. CLAYPOOLE

having been first duly sworn, deposed and testified as follows:

Direct Examination

Q. (By Mr. Mortenson): State your name, please. A. Paris B. Claypoole.

Q. What is your present business address?

A. Suite 709 Rowan Building, 458 South Spring Street, Los Angeles.

Q. What is your business or occupation?

A. I am presently engaged in income tax practice, income tax consultant.

Mr. Machtinger: We will stipulate he is the

* Page numbers appearing at top of page of Original Deposition.

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

same Mr. Claypoole that testified in the Gibney case, and his functions and duties were the same, he would now testify they were the same as he testified in the Gibney deposition.

Mr. Mortenson: So stipulated.

Mr. Lavine: So stipulated.

Q. (By Mr. Mortenson): Were you formerly an Internal Revenue Agent? A. Yes, sir.

Q. And are you retired from the Service, the Internal Revenue Service?

A. Yes, I retired on December 31, 1953. [2]

Q. What was your official position on the day of your retirement?

A. Internal Revenue Agent.

Q. Were you at that time a Group Supervisor?

A. No, sir.

Q. Had you been a Group Supervisor in Los Angeles prior to your retirement?

A. Yes, sir.

Q. When were you first assigned to the Los Angeles office of the Bureau of Internal Revenue, Mr. Claypoole? A. About August 4, 1930.

Q. Later were you made a Group Supervisor?

A. Yes, sir.

Q. And what year was that?

A. March 17, 1941 to September 30, 1949.

Q. During the time you were an Internal Revenue Agent and Group Supervisor, was Oren E. Cummins an Internal Revenue Agent in that group, which was the Fraud Group? A. He was.

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

Q. Do you know when Mr. Cummins became a member of the Fraud Group?

A. No. Mr. Cummins was a member of the Group when I arrived in Los Angeles. He was assigned to it.

Q. So that you know he was a member of that group from 1930 until the time you left, is that correct? [3] A. Yes, sir.

Q. During the time you were an Internal Revenue Agent in the Fraud Group, were you generally familiar with the type of work performed by Mr. Cummins? A. I was.

Q. Were you generally familiar with the cases on which he worked? A. I was.

Q. What proportion of the cases assigned to Mr. Cummins involved persons suspected of criminal evasion of tax?

A. It was my recollection that all of them were.

Q. I show you a list of names which appear under certain dates, which I believe is a copy of an exhibit in the Civil Service file. Would you identify that, Mr. Lavine?

Mr. Lavine: That appears to be the same list, Mr. Mortenson.

Mr. Machtinger: That is Exhibit B in the Civil Service file.

Mr. Lavine: In the Cummins file it is Exhibit D.

Q. (By Mr. Mortenson): After examining that list of names, Mr. Claypoole, do you recognize and do you recall any of the individuals listed there?

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

A. Yes. Most of them are quite familiar to me, and I recall almost all of them. [4]

Q. Were any of the individuals named classified in what was known as the "racketeer" category?

A. Yes, sir.

Q. Would you say there were quite a number which would be so classified?

A. Yes, I would say so.

Q. To your knowledge, was Mr. Cummins assigned to cases which required him to have personal contact with individuals who were known to be hoodlums or questionable characters?

A. Yes, sir.

Q. During the period from 1930 until you left the Fraud Group, what proportion of Mr. Cummins' time was involved in the investigation of individuals suspected of criminal fraud?

A. It is my recollection that all of that time was devoted to such investigations.

Q. Mr. Claypoole, you have previously testified in a similar matter involving a retirement case on the part of Internal Revenue Agent L. W. Gibney. Would your answers regarding the functions and duties of Revenue Agents and Special Agents be the same or different?

A. My answers to those questions would be the same.

Mr. Mortenson: May it be stipulated, Mr. U. S. Attorney, that the questions and answers in the case of Gibney versus United States, Civil Action

Plaintiff's Exhibit No. 1—(Continued)

(Deposition of Paris B. Claypoole.)

No. 19867-Y, be [5] made a part of this deposition, insofar as they relate to Mr. Cummins' case, the testimony of Mr. Claypoole, and that such questions and answers be copied physically into this deposition by the reporter?

Mr. Lavine: It may be so stipulated that the entire testimony, both direct, cross, redirect, re-cross, and so forth, may be so handled.

Mr. Mortenson: Very well. I have one further question.

Q. With regard to the cases investigated by Mr. Cummins, were Special Agents assigned to work jointly with him in most or all of the cases?

A. I would say in most of them.

Q. Will you explain generally the functions of a Revenue Agent and of the Special Agents when they are conducting a joint investigation in a criminal fraud case?

A. The function of the Revenue Agent was to establish a correct income tax liability of the taxpayer, to determine if there was a fraud involved in the case; if he had established sufficient indication of fraud, he thereupon would request the cooperation of a Special Agent. After the Special Agent was assigned to the case the Agents worked jointly, the Revenue Agent completing his investigation and preparing a report of his findings and his recommendations, and thereafter the report was submitted to the Special Agent and the Special Agent prepared his report and made his recommendations

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)
concerning the matter of fraud or otherwise. [6]

Q. During the conduct of a joint investigation for criminal income tax fraud, did the Special Agent have authority to order the Revenue Agent to perform any particular act?

A. I would say that he had not.

Q. Who was the immediate supervisor of the Revenue Agent regularly assigned to such a joint investigation?

A. A Revenue Agents' Group Supervisor.

Q. Who was the immediate supervisor of the Special Agent who was assigned to a joint investigation?

A. The Group Supervisor of the Special Agent.

Q. Under the rules and regulations, did the Special Agent assigned to a joint investigation have any disciplinary powers over the Revenue Agent who was assigned to that same case?

A. None whatever.

Q. After a Special Agent had been assigned in a criminal fraud case, normally what was the function of the Revenue Agent in that case?

A. The normal function of the Revenue Agent was to complete his technical examination of the tax liability, make his report, and to cooperate with the Special Agent on all of his assignments in connection with the case.

Q. In actual practice, Mr. Claypoole, can you say that there would be a division of duties that

Plaintiff's Exhibit No. 1—(Continued)

(Deposition of Paris B. Claypoole.)

would relate to criminal features of a case, as distinguished from [7] non-criminal features?

A. I have never so construed it.

Q. When reference is made to the instructions which state that the Special Agent is responsible for the criminal features of a fraud investigation, what do you interpret that to mean?

A. I have always interpreted that to mean that he was responsible for assembling in his report all evidence as to criminal liability, and that his report contained recommendations concerning that liability.

Q. How many years of experience did you have in fraud investigations as an Internal Revenue Agent and Group Supervisor?

A. My first fraud investigation was made sometime in the year 1921, and continued without interruption until September of 1949, and from September 1949 until December 31, 1953 I devoted some time to fraud investigations.

Q. From your long experience in this field, Mr. Claypoole, as between a Revenue Agent and the Special Agent, which one is more likely to spend time with the taxpayer, his associates and his employees, where there is a joint investigation for criminal fraud?

A. The Revenue Agent.

Q. In the ordinary criminal fraud case, from your experience would you say that the Revenue Agent would be most likely to be the first to talk to the taxpayer, or [8] would it be the Special Agent?

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

A. My experience has been that it is almost invariably the Revenue Agent has made the first contacts with the taxpayer and his representatives.

Q. During the time that you investigated fraud as an Internal Revenue Agent, or during the period when you were a Group Supervisor, did you learn of threats or acts of violence against Internal Revenue Agents? A. None whatever.

Q. From your experience in the criminal fraud field, Mr. Claypoole, would you say that Revenue Agents, as compared with Special Agents, were exposed to more danger, the same danger, or less danger?

A. I would say more danger; and qualify it to this extent, that the Revenue Agent spent more time with the taxpayer and his representatives, and for that reason only would there be more danger. In no circumstance that I can recall would there be less danger.

Q. Mr. Claypoole, assuming that a taxpayer kept a double set of books, one of which contained figures corresponding with those on the tax return, and another set which accurately reflected his gross and net income, which was higher than the amount reflected in the return, as between the Revenue Agent and the Special Agent, who would examine those books, audit them, and report on them?

A. The Revenue Agent.

Q. And in your experience, in such a type of case, [9] who would be the witness for the Govern-

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

ment in testifying concerning the contents of the books, and such interpretations as might be derived from the circumstances?

A. The Revenue Agent.

Mr. Machtinger: May I ask if you would read the latter part of his question again? "Contents of the books" and what else?

(The question was read.)

Q. (By Mr. Mortenson): In your experience in the investigation of fraud cases, Mr. Claypoole, and their prosecution in the Federal District Court, can you state whether more Revenue Agents or fewer Revenue Agents, as compared to Special Agents, were witnesses for the Government?

A. Well, I would say that in my experience, the Revenue Agents were almost universally the Government's witnesses, and would carry the burden of prosecution which resulted from the investigation.

Q. When an expert witness was called for computation of tax to verify the allegations in the indictment, would a Revenue Agent be called as a witness, or a Special Agent?

A. A Revenue Agent would be called.

Q. In your experience in fraud prosecutions, were there any cases of prosecution for tax evasion where a Special Agent conducted the investigation without the cooperation of a Revenue Agent or a Deputy Collector? [10]

A. None whatever.

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

Q. What, during the time you were an Internal Revenue Agent and Group Supervisor, was used as Exhibit 1 to the Special Agent's report which went forward with the recommendation for prosecution? A. The Revenue Agent's report.

Q. And briefly, Mr. Claypoole, will you tell us what that Revenue Agent's report ordinarily contained?

A. The Revenue Agent's report contained all of the data necessary to establish the tax liability of the taxpayer, and all other information pertinent to the establishment of fraud and/or criminal prosecution.

Q. Can you state who made the computations which went into the tax deficiency figures that appeared in the indictments?

A. The Revenue Agent.

Q. Do you recall when the Intelligence Unit first became a part of the Treasury Department?

A. It is my recollection that it was sometime in 1919, just about the time I entered the Internal Revenue Service.

Q. Prior to the time that the Intelligence Unit was organized, were investigations of tax evasion conducted and were prosecutions had?

A. Yes.

Q. I understand you to say, then, that investigations and prosecutions for tax evasion preceded the time when there were Special Agents?

A. I would have to qualify it to this extent, that it is my recollection that there was. Now, it

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

may have happened immediately after they created the Intelligence Unit. It is my recollection now that it had occurred prior to the formation of the Intelligence Service.

Mr. Mortenson: That is all. Any cross-examination?

Mr. Lavine: Yes.

Cross Examination

Q. (By Mr. Lavine): Mr. Claypoole, as I understand it, in the investigation of a criminal fraud case there are normally two elements in the case, both factually and legally. Those are, (1) the auditing feature, whether there is a tax due or not; and (2) whether there is any criminal intent. Is that a correct summary of the elements of a criminal tax case? A. That is right.

Q. Now, directing our attention to the first element, the audit feature—is there a tax due?—whose responsibility was it primarily to establish that in a joint investigation?

A. The Internal Revenue Agent.

Q. Now, turning our attention to the second element, [12] that of the criminal intent, whose responsibility was it primarily to develop that feature of the investigation?

A. Well, that was joint, although the question of what is criminal and what is not criminal is always a matter of the greatest concern to all parties, and the mimeographed instructions in recent years provided that that was the Special Agent's option.

Plaintiff's Exhibit No. 1—(Continued)

(Deposition of Paris B. Claypoole.)

Q. In this connection, I would like to read to you Section 4566.1 (1) of the Internal Revenue Manual, which was in effect at the time that Mr. Cummins retired and applied for retirement under the provisions of the law upon which this case is based, which reads as follows, and I quote:

“Responsibility in all full-scale investigations for the development of evidence and for recommendations pertaining to the potential criminal features of the case and the ad volorem additions to the tax for civil fraud, negligence or delinquency (excepting those concerning the tax estimations) shall be that of the Special Agent unless and until he withdraws from the case. He will be responsible for the method of procedure and conduct of the investigation. The cooperating officer will be responsible for the audit features of the case. The [13] Internal Revenue Agent will also be responsible for taking any action necessary to protect the interests of the Government in respect to the statutory period for assessment.”

Now, having read to you that regulation, does that represent during the period of years related to, the division of responsibility between the Internal Revenue Agent and the Special Agent in the conduct of a joint investigation?

A. I am quite familiar with the matter that you have just read. It was a matter of continuous discussion throughout the years whose responsibility was it to do this or that or the other thing. The

Plaintiff's Exhibit No. 1—(Continued)

(Deposition of Paris B. Claypoole.)

Revenue Agent was very often—and in a number of cases, the case was completed before a Special Agent was in the case, all of the evidence was established. Now, that was true in cases that other men with whom I had worked engaged in. So it was not a clearly defined area. There was always a hazy grey area as to where one man stopped and the other man took over.

Q. Do I understand that you say this was a controversial point which in some cases the Internal Revenue Agent almost completed, or in your words, completed his investigation before the Special Agent came in, and finally through the haziness and confusion and mild controversy the matter was determined and delineated by an appropriate [14] regulation?

A. No. That is restating old regulations. You see, originally it started out that there were no regulations at all, and the Revenue Agent originally presented his case upon direction of the Commissioner to the United States Attorney. Then the next step was they established an organization in Washington in the Chief Counsel's office in the Audit Division to review those matters, and then the Special Agent's case, and both reports were examined; and throughout the years there has been a change in those regulations and procedures; and there always has been, and it may be to this day, so far as I know, still some area that is not clearly defined, because as was pointed out at the beginning,

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

the Revenue Agent when he makes his investigation, he has to first determine whether there is evidence of fraud. Now then, when he is determining evidence of fraud, frequently he has to establish all of the facts necessary for prosecution, and that is why the Revenue Agent has done his work, and then the Special Agent is called in merely as a procedural matter in many cases—and this happened many, many times—because of the matter of processing his report and the Revenue Agent's report.

Q. Does this regulation then pretty much embody the principles upon which the earlier regulations and procedures were based?

A. Well, there are modifications that I at this [15] moment couldn't specify, wherein they are; but it has been out of this area of disagreement for years. It has been straightened out where there was no conflict between the two branches, because frequently it was quite customary for the Revenue Agent to carry the burden of the case from the beginning right down until the jury brought in a conviction or the equivalent. That has happened many, many times throughout the years.

Q. Now, let us take a typical case by way of example, say investigating Mr. Smith. Let us say for example there is nothing special about Mr. Smith, he owns just a factory down the road, and the Internal Revenue Agent, Field Division, or whatever you call it, is performing some work, and he audits the books for a period of two or three

Plaintiff's Exhibit No. 1—(Continued)

(Deposition of Paris B. Claypoole.)

years, whatever the case might be. Upon the compilation of all his figures, he finds or suspects that there is fraud. What does he do at that point?

A. Are you speaking of presently, or what happened——

Q. Well, let us take a period prior to 1947.

A. Well, in that period—and that was during the period when I had the group over there—this is what happened: If that situation developed in any group outside of my group, when the case was assigned to me I looked into it, I sized up the Agent to find out how well qualified he was, and if he was well qualified he was automatically shifted over to my group or supervision, during which time [16] I supervised his work on that case, carried it on to such time as I believed it was concluded, and if necessary we called in a Special Agent.

Now, if it happened in my own group, as we did have those things happen, the Agent would carry right on up to the point where we decided, "Well, this is the time we have to call in a Special Agent; there is evidence of fraud here, here are the facts that we have developed here," and so forth. Then we would call in a Special Agent.

Q. And from that point on what would the Special Agent do in that investigation?

A. Well, to be brutally frank, and to say something I don't like to say, in many cases nothing but

Plaintiff's Exhibit No. 1—(Continued)

(Deposition of Paris B. Claypoole.)

take the Revenue Agent's report and paraphrase it and make his recommendations.

Q. Would it be the responsibility of that Special Agent to go out and further develop the element of intent, or any other criminal elements that were missing so far in the investigation?

A. If there was anything missing, yes; but frequently it happened, and it happened quite often, there was nothing missing in the cases, and that happened very frequently. It is something that I would prefer not to say about my friends in the Intelligence Unit, but it was a fact.

Q. Now, let us take a similar situation. We have Mr. Joe Jones down the street, who is suspected of being a [17] bookmaker, and a member of your squad is designated to audit his returns for the last three-year period prior to 1947. What happens in that situation?

A. In that case the Agent would proceed with his investigation, and to reach that point in the investigation where we believed that there was sufficient evidence to justify the request for the cooperation of a Special Agent. And sometimes actually in a case like that we would find no evidence of fraud. He might be suspected of being a bookie, and we found no evidence of it, and we closed the case there, and no Special Agent ever appeared in the case.

Q. And during this period of time in which you were working on the case, in the meantime is he

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)
supposed to go to the taxpayer and tell the taxpayer fraud is suspected?

A. I didn't quite follow you.

Q. During the period of time at which your Internal Revenue Agent is working on the case of Joe Jones, bookie, is it part of his responsibility, or does he customarily go to the taxpayer and tell him, "You are suspected of fraud, and I am working on that"?

A. Oh, no, no. No, the Agents never tell a taxpayer that they suspect him of fraud, because there may not be any suspicion of fraud. There may be just suspicion, and there may not be any fraud there.

Q. So before the taxpayer is told, there must be something more than a suspicion? [18]

A. Yes.

Q. There must be a case actively in process, is that correct?

A. Yes. The matter of telling a taxpayer whether there is fraud, they usually don't learn that now until they are just down here ready to present it to the Grand Jury. That is one of the other grey areas. The taxpayer is most anxious to find out when the Government thinks there is fraud in the case, and they can't find out.

Q. At any time during the investigation by the Internal Revenue Agent is the taxpayer warned of his Constitutional rights that anything he may say

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

may be held against him, or his right to consult counsel, and the like?

A. Oh, yes, yes. That has been a practice universally followed, and I followed it. I think most of the men in my Group did; they cautioned them as to their rights, and they were certainly instructed to, because that was one of the situations that might make or break a case, on that very point.

Q. At what point would the taxpayer be so warned?

A. That is something that would depend on a particular case. I have done it immediately, and I have done it sometimes quite a bit later. You have to wait for an appropriate circumstance to do that. The Agent does not go in to a taxpayer and say, "I warn you of your rights, I am going to use it against you." No, he can't do that. [19]

Q. Would the taxpayer be informed that the man working on his books was a member of the so-called Fraud Group?

A. They were most anxious, and the tax counsel in a city like Los Angeles were most anxious to find out what Group the man was in, and if he was in Claypoole's Group, the Fraud Group, the tax counsel became very active immediately.

Q. But as a matter of fact, until a Special Agent entered the picture, the taxpayer would not necessarily know that there was a fraud case actually against him?

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

A. He does not know it even when the Special Agent is in the picture.

Q. You testified you have not known of an instance in which an Internal Revenue Agent has actually been threatened or has met with physical violence from the taxpayer. Were any other members of your Group authorized to carry firearms?

A. No.

Q. Didn't they carry firearms as part of their duty? A. No.

Q. Was it the responsibility of your Group to present matters to the United States Attorney for prosecution?

A. Actually it was a matter of rightful practice, the United States Attorney or a United States Attorney sought our agents to present cases to the Grand Jury, and [20] usually—Now, there are always of course exceptions, but I would say in my experience that usually the Revenue Agent presented the evidence, and I have appeared before Grand Juries from one end of this country to the other throughout the years, and in only two or three cases that I can recall now did a Special Agent appear, but the Revenue Agent that has done the work has to testify at first hand on the facts. That is the experience that we have.

Q. But the initial reporting to the United States Attorney that a crime has been committed or was suspected of being committed, was that a part of the duty of your group?

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

A. No. That is a procedural matter. It is not the Special Agent's business either. That is a special matter that goes to the Attorney General of the United States, where they take all these reports, the Special Agent's report and Revenue Agent's report; it goes to Washington and ultimately it ends in the Attorney General's office in Washington. The first procedure that I testified about was that in which the Commissioner wrote a letter authorizing and directed to the Revenue Agent to present the case to the United States Attorney.

Q. To what year are you referring?

A. That was back in the very early part.

Q. Will you take it chronologically, so we can get what the changes were? [21]

A. Yes, I will be glad to. That was in the early 20's. Then there was set up in Washington in the Chief Counsel's office a division, the title of which—I don't remember—the Penal Division, who were engaged on reviewing reports of the Special Agents and Revenue Agents. There was also set up a Special Adjustment Section in the Internal Revenue Bureau in Washington, this Special Adjustment Section, whose duty it was to examine and review carefully the technical details of all fraud cases. If the taxpayer requested it, or his counsel, conferences were held in Washington with the Penal Division and the Special Adjustment Section, whose duty it was to examine and review carefully the technical details of all fraud cases. If the taxpayer

Plaintiff's Exhibit No. 1—(Continued)

(Deposition of Paris B. Claypoole.)

requested it, or his counsel, conferences were held in Washington with the Penal Division and the Special Adjustment Division for hearing, and if the case was then found to be one where prosecution should be had, it was referred to the Attorney General, who in turn sent it to the United States Attorney in the particular district, and it was then presented to the Grand Jury. At that time it was the usual practice, at least in my experience, to call Claypoole as a witness to appear before the Grand Jury; and as I say, through the years there were only two or three experiences of my own in which Special Agents appeared.

Q. This was only up to 1947 or 1946?

A. This is through 1949.

Q. Through 1949? [22]

A. Well, now—oh, pardon me. I spoke out of turn. They set up about 1946—they decentralized this Washington arrangement and established here in San Francisco an office where the cases went there, where before they went to Washington. The purpose there was to do the work closer to home, because Washington was so far away for most people.

Q. Are you acquainted with instances in which the United States Attorney or Assistant United States Attorney has actually performed investigating work on a particular case, Mr. Claypoole?

A. Well, I have spent much time with Assistant United States Attorneys in these cases in one part

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

of the country and another, and I have never yet known of them to do any investigating work.

Q. Would your answer be any different if I were to tell you that I in a particular tax case have made numerous trips, in one case to another State, in order to develop and talk to witnesses and find documentary evidence?

A. I would commend you very highly for your industry.

Q. Are you acquainted with the action Mr. Cummins has brought in this case, Mr. Claypoole?

A. Only in a very vague way.

Q. I will state, before asking you the next question, that it is an action for a certain sum of money to him for declaratory relief, brought by Mr. Cummins against the United States, on the basis that the Department of the [23] Treasury and the Civil Service Commission have wrongfully denied him his rights to retirement under a certain statute known as 691B, Title V. Are you acquainted with that statute?

A. I have never read it. I have never even taken the time to look at it.

Q. In your opinion, does the outcome of Mr. Cummins' case have any bearing at all upon any retirement rights which you might have or claim against the United States?

A. It may have. I personally have no intention of doing anything about it, I am not interested in it. I put in many years in the Service, and I re-

Plaintiff's Exhibit No. 1—(Continued)

(Deposition of Paris B. Claypoole.)

tired, and I am now gainfully employed outside, and I have no interest in it whatsoever.

Mr. Lavine: That is all. Do you have any questions?

Cross Examination

Q. (By Mr. Machtinger): When an Internal Revenue Agent assigned to the Fraud Squad prepared his report after the conclusion of an investigation, did he make a recommendation specifically for or against criminal prosecution?

A. That was somewhat of an open question. Some did and some did not. It was a matter somewhat of the attitude [24] of the agent and what he thought of the case. We usually tried to leave that open, because we didn't want a conflict in recommendations.

Q. Isn't it true that his main responsibility in his report was to present his case as far as the deficiency is concerned in any civil 50 per cent fraud penalty that he may recommend or not recommend?

A. Yes.

When you say "civil fraud penalty," though, in a case where the Statute of Limitations is still open for criminal prosecution, where you have got a civil fraud case, you usually have a criminal case, and there was very little difference, and I don't know of anyone that has yet been able to distinguish the difference between what is civil fraud and criminal fraud in a given case, when the Statute of Limitations has not expired on criminal prosecution.

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

Q. But aside from the distinction between the two, was it not the responsibility of the Special Agent to make his recommendation for the criminal aspects of the case, and the responsibility of the Internal Revenue Agent to make his recommendation with respect to the deficiencies due from the taxpayer? A. That is right.

Q. Weren't there many cases when an Internal Revenue Agent not assigned to your group virtually completed a case in which he had discovered all of the facts necessary [25] to prove criminal fraud, at which time the case would then be transferred to your group?

A. I do not recall that. We had rather a strict rule over there about that situation, and if anyone discovered evidence of fraud, he usually contacted me personally just as quickly as he could, and we would take it from there. I am quite sure that never happened during my tenure.

Q. But you did testify that there were instances in which an Internal Revenue Agent of the Field Division who had completed a large portion of the work necessary for the audit aspects, and whom you considered to be a capable agent, was then assigned, I gather temporarily, to your Group for the completion of the case?

A. You said "a large portion of the audit." No. Usually when they found evidence of fraud and they came to me with a problem, if I felt that they were qualified to carry on, they were automatically

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

transferred into my group and under my supervision for that case, and frequently remained there forever after working on other cases.

Q. But there were Agents who did not remain and who after the completion of the case went back to their regular duties?

A. There were Agents who not only did not remain, but did not complete the cases, and we took them away from [26] them and gave them to an agent who could really do the job.

Q. Well, let me ask you, there were Agents who did complete the investigation with a Special Agent, and were then re-transferred to their duties?

A. That is right.

Q. Did an Internal Revenue Agent attached to your unit ever go ahead with a criminal investigation where the Special Agent stated in his opinion there was no criminal case, and refused to go ahead with it?

A. No.

Q. If the Special Agent refused to go ahead with it, then the criminal aspects of the case were dropped, is that correct?

A. We didn't pursue the case beyond that, no.

Q. But the man assigned to your unit would continue with the investigation of the case, as far as the civil aspects were concerned?

A. We never had any cases like that over there during my time.

Q. Regardless of your personal feelings as to what was accomplished when you called in Special

Plaintiff's Exhibit No. 1—(Continued)

(Deposition of Paris B. Claypoole.)

Agents, it was nevertheless necessary to call in a Special Agent if you were going to fully investigate a taxpayer for criminal purposes, is that right?

A. It was necessary to call in a Special Agent to comply with the regulations and the directives. [27]

Q. You stated before, I think quite accurately, the chronological sequence of the investigation reports. Now, the Regional Counsel's office that was referred to by Mr. Lavine, is a branch of the Chief Counsel's office, is that right? A. Yes.

Q. And all that was accomplished by the change was decentralizing the functions that had been performed previously in Washington to the local offices? A. That was the intent.

Q. And isn't it true that no criminal case was ever commenced unless the Regional Counsel or the Chief Counsel concurred in their recommendation to the Department of Justice that an indictment be sought? A. Was commenced, you mean?

Q. Let me rephrase that. The Regional Counsel or Chief Counsel had the authority to kill a case at his level, is that right? A. Yes.

Q. Were you in the Los Angeles office when the so-called Racket Squad was organized?

A. No, sir.

Q. Do you recall when the position of Technical Advisor to the Regional Counsel was created?

A. Yes, sir.

Q. When was that? [28]

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

A. I can't recall the date. I remember the circumstances.

Q. Do you remember the year?

A. No, I do not. I am not exactly sure as to the year.

Q. That is all I am interested in right now.

A. But I remember the circumstances.

Q. You don't remember the year? A. No.

Mr. Machtinger: I think that is all. No more questions.

Mr. Lavine: I have no further questions.

Redirect Examination

Q. (By Mr. Mortenson): Mr. Claypoole, if a taxpayer made admissions which could be used by the Government in a prosecution, were such admissions made part of the Revenue Agent's report?

A. Yes, sir.

Q. Was it customary procedure to include in the Revenue Agent's report any incriminating admissions made by the taxpayer? A. It was.

Q. When the questions were asked about the audit features of a criminal investigation case, just what did [29] that include?

A. Let me get that question again.

(The question was read.)

A. well, I—

Q. Let me rephrase my question.

A. All right.

Q. When you answered the questions concerning

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

the audit features of a fraud investigation, what did you mean to include in the audit features?

Mr. Machtinger: Mr. Mortenson, are you referring to specific answers to specific questions?

Mr. Mortenson: Yes.

Mr. Machtinger: Could you be a little more specific as to the questions that you are referring to? I myself don't know, and I think Mr. Claypoole is puzzled also as to what questions you are referring to.

Mr. Mortenson: Mr. Reporter, will you read the question in which Mr. Machtinger asked about the audit features of a case being the responsibility of the Revenue Agent?

Well, let me ask the direct question instead, and that will solve that.

Q. The instructions to Internal Revenue Agents referred to audit features of a case being the responsibility of the Revenue Agent. What is your interpretation of the words "audit features," Mr. Claypoole? [30]

A. Well, my interpretation of the "audit features" of a case is that the Revenue Agent should have completed his investigation to the point where he could include in his report all matters pertaining to the tax liability of the taxpayer, and all evidence of the facts indicating either civil or criminal penalties, and do it in such a way that he would be prepared not only to present the matter to a Grand Jury, but to testify as a witness in a civil or

Plaintiff's Exhibit No. 1—(Continued)
(Deposition of Paris B. Claypoole.)

a criminal case, either before the Tax Court or the United States District Court.

Q. In addition to securing evidence which would be used in the actual tax computations, what further duties did the Revenue Agent have in a fraud classification?

A. He had the duty of gathering of evidence to support the conclusion that is set out in his report, all the auditing features in an income tax investigation, every bit of evidence that was closely related to the audit features of the case.

Mr. Mortenson: No further questions.

Mr. Lavine: No further questions.

Mr. Machtinger: No questions.

(It was stipulated and agreed by and between counsel that the foregoing deposition shall be signed before any Notary Public, with the same [31] force and effect as though read and signed in the presence of the Notary Public before whom it was taken.)

/s/ PARIS B. CLAYPOOLE,
Signature of Witness.

Subscribed and sworn to before me, this 16th day of October, 1956.

[Seal] /s/ ELSIE GALE,
Notary Public in and for the County of Los Angeles, State of California. [32]

[Endorsed]: Filed October 19, 1956.

PLAINTIFF'S EXHIBIT No. 2

[Title of District Court and Cause.]

DEPOSITION OF VINCENT B. MURPHY

taken on behalf of the plaintiff, at Suite 625, Federal Building, Los Angeles, California, commencing at 10:00 o'clock a.m., Wednesday, October 10, 1956, before Charles C. Jenkins, CSR, Notary Public, pursuant to the annexed Stipulation.

Appearances of Counsel: For the Plaintiff: Ernest R. Mortenson, Esq. For the Defendant: Laughlin E. Waters, United States Attorney, Max E. Deutz, Assistant United States Attorney, Chief of Civil Division, by Richard A. Lavine, Assistant U. S. Attorney and Sidney J. Machtinger, Special Attorney, Internal Revenue Service. [1]*

VINCENT B. MURPHY

having been first duly sworn, deposed and testified as follows:

Direct Examination

Q. (By Mr. Mortenson): Mr. Murphy, will you state your name? A. Vincent B. Murphy.

Q. And what is your business or occupation?

A. Internal Revenue Agent.

Q. Are you also a Group Supervisor?

A. I am Supervisor of Group No. 7.

Q. And where is your office located?

A. In the Federal Post Office and Courthouse in Los Angeles.

* Page numbers appearing at top of page of Original Deposition.

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

Q. When were you made Supervisor of Group No. 7? A. October 2, 1949.

Q. On inter-office communications, what is the name usually given to Group No. 7?

A. Fraud Group.

Q. Before you were named Group Supervisor of the Fraud Group, what were your duties in the Internal Revenue?

A. Internal Revenue Agent in the Fraud Group.

Q. When did you first become acquainted with Oren E. Cummins? [2]

A. When I first came to California as an agent on January 2, 1938.

Q. What position did Mr. Cummins hold in 1938, if you recall?

A. He was an Agent in the Fraud Group, under the supervision of Mr. Warner E. Williams.

Q. Were you a Revenue Agent in the Fraud Group in 1938? A. I was.

Q. When you became Group Supervisor on October 2, 1949, what position did Mr. Cummins hold?

A. He was still a Revenue Agent in the Fraud Group.

Q. Do you recall when Mr. Cummins retired from the Service? A. December 31, 1954.

Q. Mr. Murphy, would you explain generally the functions of a Revenue Agent and the functions of a Special Agent during the time they conduct a joint investigation for fraud?

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

A. Well, first of all, some cases originated, some allegational fraud cases originated in our Group, the Fraud Group, and some originated in the Special Intelligence Unit. If they originated in the Fraud Group, the Agent would make his investigation up to a point where he would have indications of fraud.

Q. Pardon me. By "Agent" you mean Revenue Agent? [3]

A. Revenue Agent. At that time he was instructed to cease operations and ask for the cooperation of a Special Agent. If the case was accepted for joint investigation by the Special Agent, they would then work together, the Revenue Agent and the Special Agent would work together to carry the case through to completion. At the end of the examination, the Special Agent would then submit the case with his recommendations as to whether he thought criminal action should be taken.

Q. During the investigation, roughly what were the duties of the Revenue Agent?

A. The Revenue Agent's duties were the audit features of the case. The Special Agent's duties were to procure evidence for criminal prosecution.

Q. By "evidence for criminal prosecution" do you mean evidence relating to the element of criminal intent, mainly? A. Yes.

Q. During the conduct of a joint investigation, speaking about the period when Mr. Cummins was a Revenue Agent in your Group did the Special

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

Agent have any authority to order a Revenue Agent to do any particular act?

A. Well, that is a question. According to the rules and regulations, the Special Agent was supposed to be in charge of the investigation, but the Revenue Agent was supposed to be in charge of the audit features of the case, [4] so I don't think it has ever been definitely decided who was the boss, and that is a question that has been brought on as long as I can remember.

Q. Did the Special Agent have any disciplinary powers of any kind over the Revenue Agent?

A. Not that I know of.

Q. To whom did the Revenue Agent answer, insofar as supervision was concerned?

A. To his Supervisor in the Fraud Group.

Q. To whom did the Special Agent answer, insofar as authority and discipline was concerned?

A. To the Chief Special Agent.

Q. At the time that Mr. Cummins was a Revenue Agent, did the Special Agent in Charge and the Revenue Agent in Charge have a common Supervisor, or were their Supervisors independent of each other?

A. Well, at that time the only common Supervisor they had would be the Commissioner in Washington.

Q. The line of authority for the Special Agent proceeded in what way?

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

A. I think it was direct from the Commissioner in Washington.

Q. Is it true that a Special Agent would report to the local Special Agent in Charge, and the local Special Agent in Charge would report to the head of the Intelligence Unit in Washington, who in turn was responsible to the [5] Commissioner?

A. That is the way I understand it, yes.

Q. In actual practice, in the investigation of a fraud case is it possible to divide duties into criminal and non-criminal features?

A. During the investigation, I would say no; but at the termination of the investigation, there would be certain items on which they would have sufficient evidence for criminal prosecution, and other items would be just technical.

Q. Under the rules and regulations in force during Mr. Cummins' tenure, was it possible for the Special Agent to make a recommendation of prosecution without the report of a Revenue Agent?

A. No. At that time the Revenue Agent was charged with the duties of submitting——

Mr. Machtinger: At what time? Will you specify what time?

Mr. Mortenson: My question was asked during Mr. Cummins' tenure.

Mr. Machtinger: The entire time of his tenure?

Mr. Mortenson: Yes.

The Witness: The Revenue Agent is charged with the duties of preparing a confidential report,

Plaintiff's Exhibit No. 2—(Continued)

(Deposition of Vincent B. Murphy.)

which is supposed to contain all the evidence necessary for the assertion of the 50 per cent civil penalty. That report was then submitted to the Special Agent, who in turn prepared [6] his own report as to the criminal portion of the case.

Q. What was usually presented as Exhibit No. 1 to the Special Agent's report?

A. The Revenue Agent's report.

Q. Is it true that all indictments brought for evasion of tax allege an amount of tax that has been evaded?

A. No, just those portions which you are able to prove criminal intent on.

Q. In the indictment is there always an allegation concerning a specific amount of tax which has been evaded? A. I think so.

Q. Under the rules and the regulations who computed the figures for such an amount which was stated in the indictment?

A. Well, up to the time I think they formed a Technical Advisor to the Regional Counsel, I think that was done by the Revenue Agent; but after the appointment of a Technical Advisor to the Regional Counsel, I think it was his duty to compute the tax.

Q. As between a Revenue Agent and a Special Agent, whose duty would it be to compute the tax which would be stated in the indictment?

A. Well, it was always the duty of the Revenue Agent to compute taxes.

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

Q. In your duty as a Group Supervisor of the Fraud Group, and as an Internal Revenue Agent investigating [7] fraud cases, do you recall any criminal prosecution in which a Revenue Agent did not take part in the investigation, where the indictment was for evasion of taxes?

A. Yes. Deputy Collectors at time worked up fraud cases.

Q. Except then for Deputy Collectors who did the same work as a Revenue Agent, were there any cases of prosecution without an investigation by either a Revenue Agent or a Deputy Collector?

A. Not for income tax evasion.

Q. In a joint investigation for fraud as between a Special Agent and a Revenue agent, which generally spent more time with the taxpayer, his associates and his employers?

A. Well, the Revenue Agent would have to spend more time, because he had to make the audit of the case.

Q. In the ordinary fraud case, where there is a joint investigation, who generally had the first personal contact with the taxpayer, as between the Revenue Agent and the Special Agent?

A. Prior to January 1, 1955, it was generally the Revenue Agent. Since January 1, 1955, the new mimeographed 55-19 states that preliminary investigation shall be made by the Special Agent, at which time he usually contacts the taxpayer.

Q. When Mr. Cummins was a Revenue Agent

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

under your supervision, what group handled the so-called "racketeer [8] cases"?

A. A special group was formed to handle racketeer cases. I think it was about 1950 it was put under the supervision of Mr. Raymond Maddocks.

Q. Prior to the organization of this Racket Squad, and since it was dissolved, what group handled the so-called racketeer cases?

A. Group No. 7, the Fraud Group.

Q. Was Mr. Cummins during the time he was under your supervision assigned any so-called "racketeer cases"? A. Yes.

Q. Mr. Murphy, we do not wish to have any of these names entered in the record, but it is permissible, I believe, for you to refer to the individuals in a way in which they may not be identified. I hand you a list of names, and ask you whether you have seen this before.

A. Yes, I have.

Q. Was that during the period when Mr. Cummins was seeking retirement?

A. That particular list was after Mr. Cummins had retired.

Q. And what does that list represent?

A. It purports to represent cases worked by Mr. Cummins while he was a member of the Fraud Group.

Q. And as far as you know, did he investigate the cases listed on these pages? [9]

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

A. From 1949 on I know to my knowledge that he did investigate all of those cases.

Q. Now, these names are listed under years, is that correct?

A. That is correct. It lists 1949, 1950, 1951, 1952, 1953 and 1954.

Q. In how many of the cases here were the taxpayers suspected of committing criminal fraud?

A. I think in all cases.

Q. What proportion assigned to Mr. Cummins when he was under your supervision were cases in which the taxpayers were suspected of committing criminal fraud?

A. I think all cases that were assigned to Mr. Cummins by me were potential fraud cases.

Q. By that do you mean that there was a suspicion that the taxpayers could have committed criminal fraud against the United States?

A. That's right.

Q. Now, without mentioning any names, do you find on this list the names of individuals who were considered racketeers or questionable characters?

A. Yes, quite a number of them.

Q. Mr. Murphy, was there at a time a list circulated in the Internal Revenue Service, then known as the Bureau of Internal Revenue, which purported to contain names of racketeers? [10]

A. Well, there was a list made up of suspected racketeers when the Racketeer Group was formed. That is the only list I know.

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

Mr. Lavine: That is in 1950?

The Witness: 1950.

Q. (By Mr. Mortenson): Do you know whether Mr. Cummins had personal contact with individuals who had been classified as possible racketeers?

A. Well, they hadn't been classified up to the time the Racketeer Group was started, but we considered them such.

Q. That is, taxpayers investigated by Mr. Cummins were deemed by you to be racketeers?

A. Yes, and by "racketeers" we considered gamblers and other persons in the criminal element.

Q. Mr. Murphy, will you say that Mr. Cummins was exposed to danger more than, the same as, or less than the Special Agents who cooperated with him in criminal fraud investigations?

A. Well, if you base that on an element of time working on the case, I would say that Mr. Cummins worked longer on the cases as a rule than the Special Agents, and if the Special Agent was open to any acts of violence by the taxpayer, I would think that Mr. Cummins was open to the same danger.

(A short recess was had.)

Q. (By Mr. Mortenson): Mr. Murphy, in the ordinary [11] investigation of a criminal case, is it necessary for the Revenue Agent to examine some or all of the books and records of the taxpayer?

A. When he can get them, yes; but there are

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

lots of cases where we cannot get any books and records of the taxpayer.

Q. Is it ordinary procedure to attempt to inspect the books and records of the taxpayer?

A. Yes.

Q. And whose function is it to make such an inspection? A. The Revenue Agent.

Q. Mr. Murphy, do you know when the Intelligence Unit, now known as the Intelligence Division, became a part of the Treasury Department?

A. I understand it was in 1919.

Q. Was that at the time when Mr. Elmer Irey and five other Post Office Inspectors transferred to the Treasury Department?

A. That is what I am told.

Q. Mr. Murphy, do you know whether it was a crime to evade taxes prior to 1919?

A. I think it was made a crime in 1919. Prior to that it was a misdemeanor.

Mr. Machtinger: Testify personally from your own knowledge, just what you know.

The Witness: Then I can answer that and say I don't [12] know.

Mr. Mortenson: That is all I have. Do you have any cross-examination, Mr. Lavine and Mr. Machtinger?

Cross Examination

Q. (By Mr. Lavine): In reference to the questions and your answers concerning the so-called Fraud Squad activities, with the exceptions that

Plaintiff's Exhibit No. 2—(Continued)

(Deposition of Vincent B. Murphy.)

you listed, giving some cut-off dates, 1950 and 1954 and 1955, do your answers cover the entire period of service which Mr. Cummins claims to have rendered?

Before I make that into a question, I will give you some little more definite questions along that line.

As I understand Mr. Cummins' case, he lists activities from the years 1928 to 1953, inclusive, or some parts of those years. Now, in your answers heretofore, when you have described activities of the Fraud Squad, do you also refer to the periods prior to your coming to California?

A. No.

Q. In other words, your testimony only relates to the period in your personal knowledge?

A. That is right.

Q. Mr. Murphy, you described the duties of one category of Internal Revenue Agents, namely, members of the so-called Fraud Group. Prior to the time of retirement of Mr. Cummins, which was January 31, 1954, what other [13] categories were there of Internal Revenue Agents?

A. Well, there was the regular Field Agent, who made the ordinary examination.

Q. What were his duties in the group?

A. Well, he would investigate returns given him for examination, and if he should find any indications of fraud, he would immediately stop his ex-

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

amination and transfer them over to the Fraud Group for consideration.

Q. Let's go through a typical case. Supposing I am under investigation—I as an individual, not as an Assistant U. S. Attorney. Let us suppose that an audit has been made by an Internal Revenue Agent attached to the Field Unit, say Internal Revenue Agent Smith. Supposing he has made a rather complete audit of my activities over a couple of years in question and finds or suspects there is a fraud. What happens then? Is his audit turned entirely over to the Fraud Squad, or what happens?

A. At the time Mr. Cummins was with us, if any Agent found indications of fraud, they would be submitted to the Fraud Group for consideration, and if we thought that there was sufficient indication of fraud, we would then ask for a joint investigation with a Special Agent.

Q. Who would then work with the Special Agent, the original Field Unit man?

A. No, he would transfer the case to the Fraud Group, and one of the Fraud men would go after the suspect. [14]

Q. In normal circumstances would the original agent have anything further to do with the case?

A. No.

Q. Not even in a situation where he had a substantial amount of work and made extensive notes?

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

A. No, I don't ever know of an agent that has worked in the field in a fraud case.

Q. In other words, was Mr. Cummins assigned to this so-called "Racketeer Squad" during his tenure of duties? A. No.

Q. Mr. Murphy, I show you a copy of a document which is attached to a file marked "Certified and Corrected Copies of Official Documents," contained in the retirement file of Oren E. Cummins. I am not going to introduce this in evidence, because it is going to be introduced in evidence later, Mr. Murphy. I would like you to read that page and tell me whether that page is a job description, including tasks and performance standards of an Internal Revenue Agent GS-12 assigned to the Fraud Group during your term as head of that Group. Incidentally, for the purpose of referring to this, this is Exhibit E to the sheaf of documents that I have just mentioned.

Mr. Mortenson: Yes, and for further identification, it has the ending, "Internal Revenue Agent, GS-12, Assigned to Fraud Group," with signature at the bottom, "Vincent B. Murphy, Group Chief," dated 6-15-1951, with the name "Oren [15] E. Cummins, Agent," at the bottom.

Mr. Lavine: In view of the length of the question, and Mr. Mortenson's remarks, I will reframe my question.

Q. Does that page, this sheet, set forth job description, including task and performance stand-

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)
ards of Mr. Cummins, as a member of the Fraud Group?

A. It does. You said this bore my signature and the signature of Cummins. This is just a copy, with the signatures typed in.

Q. For the purposes of identification, I show you the original of which this purports to be only a certified copy of the original. The copy that I have shown you appears to be a true copy, does it not? A. It appears to be, yes.

Q. Now, as part of the duties of members of the Fraud Squad, are they authorized by law or by regulation or by custom to issue or carry firearms? A. No, sir.

Q. Do they as a matter of course carry or possess firearms? A. No, sir.

Q. Now, with reference to the degree of risk run by members of the Fraud Group, during your tenure of office were any members of your Group shot at or assaulted with deadly weapons?

A. I don't know of any Agent or Special Agent that was [16] assaulted or shot at.

Q. Approximately how many years, Mr. Murphy, have you been engaged in activities in or comparable to the Fraud Group type of work?

A. Eighteen years.

Q. Are you aware of the nature of the case brought by Mr. Cummins? A. I am.

Q. In the event that Mr. Cummins should be successful in this case, would not the outcome of

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

this case serve as a precedent which would bear some possible relationship to your retirement rights? A. It is possible.

Q. With reference to the conduct of a fraud investigation case, as I understand it, Mr. Murphy, there are two parts or elements that must be established in a criminal fraud case, are there not; and those two elements may be broadly defined as the audit features of the case and the feature of establishing criminal intent? A. That is right.

Q. Is that a fair division? A. Yes, sir.

Q. In the initial part of the investigation, whether it be for fraud or otherwise, does not the Internal Revenue Agent conduct the audit feature of the case? A. Those are his duties. [17]

Q. And at some time during pursuit of that audit investigation, he may or may not discover something which causes him to suspect fraud, or which involves a criminal intent; is that correct?

A. That is right.

Q. And at that time he makes his initial report, and report of suspicions through channels to the Intelligence Unit, is that also correct?

A. That is true as far as the regular Field Group is concerned, but in the Fraud Group we usually went farther than that.

Q. Would you elaborate on that, please?

A. We even went so far as to get evidence which was later given to the Special Agent as a part of the criminal action.

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

Q. In relation to what features of the case?

A. Any evidence, which we found during the course of an audit; or lots of times we would find documents in the taxpayer's files which would be very valuable in the criminal case, and we would have those photostated, so that we would have them when they were necessary.

Q. In other words, the Internal Revenue Agent didn't close his eyes to the criminal intent features, but what he discovered he would turn over to the Special Agent?

A. Yes, or he would include them in his confidential report lots of times, and the Special Agent would get a copy [18] of it.

Q. Now, during the meeting in respect to the taxpayer, an Internal Revenue Agent examines his returns, his books and records, and makes an audit in the normal course of affairs. Isn't there a specific time in which the taxpayer realizes that a Special Agent has been called into the case?

A. Usually when the Special Agent shows up in his office and tells him he is from the Intelligence Unit.

Q. Isn't that normally the first time that the taxpayer realizes that he faces a potential criminal suit?

A. Yes, I would say so.

Q. And it is normally at that point that the taxpayer has real cause for alarm that a suit is very possibly in the offing, is that right?

A. Yes.

Plaintiff's Exhibit No. 2—(Continued)

(Deposition of Vincent B. Murphy.)

Q. So prior to that time, so far as the taxpayer is normally concerned, he hopes everything is going along smoothly, and he has nothing to worry about; is that correct?

A. Well, that depends on what kind of a conscience he has got.

Q. Well, prior to that time he has no special reason to believe that the Internal Revenue Agent is looking for or pointing at fraud, does he?

A. No, sir.

Q. Have you had occasion to work on any cases with a U. S. Attorney or the U. S. Attorney? [19]

A. Yes.

Q. And during the investigation of those cases, has it been a fact that the Assistant U. S. Attorney assigned the case has himself actively worked at finding evidence, such as examining witnesses and going out and looking at documents?

A. Yes, sir.

Q. Going out to banks and looking at records in some cases?

A. Well, usually they call for the Revenue Agent to go out and get copies of the records.

Q. In other words, the Internal Revenue Agent is the "leg man," to use the slang expression. But so far as the development of a case, has it been your experience an Assistant U. S. Attorney has in cases where it is necessary to further develop the case, performed certain of the duties that normally would be those of the Special Agent?

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

A. Yes, sir.

Q. And some of the duties which fall in the purview of the Internal Revenue Agent?

A. Sometimes, yes.

Q. Now, is there a Division of the Internal Revenue Service which passes upon the sufficiency and legality of a criminal fraud case?

A. Yes, sir; the Regional Counsel's office.

Q. To your knowledge, what sort of work is done by the Regional Counsel's office in this case?

A. Well, they prepare the case for trial and line up the witnesses, and see that the evidence is sufficient to uphold the criminal charges.

Q. In your experience, in certain cases have members of the Regional Counsel's Office, in cooperation with the Internal Revenue Agent, Special Agent, performing some of the duties of investigation, overlapped those of the duties of the Internal Revenue Agent?

A. At times when the evidence is not clear, they will ask for verification and ask for additional evidence.

Q. And have they had occasion to interview some of the potential witnesses?

A. Yes, sir.

Q. And criminal fraud cases?

A. Yes, sir.

Q. And to interview the taxpayer in some cases, when appropriate?

A. Yes, sir.

Q. Perhaps to go out to the taxpayer's premises on occasion?

A. Well, I don't know whether they go out to

Plaintiff's Exhibit No. 2—(Continued)

(Deposition of Vincent B. Murphy.)

the taxpayer's premises, but I know they have interviewed taxpayers.

Q. Suppose there is a situation, Mr. Murphy, where the Internal Revenue Agent has reported fraud, and the Special Agent has been called into the case, the Special [21] Agent has done a certain amount of investigation. Can the Internal Revenue Agent proceed with the development of a fraud case if the Special Agent says no, or refuses to acquiesce in a report recommending fraud?

A. As far as criminal action is concerned, why, when the Special Agent says he will not recommend it, there will be no criminal action; but the Revenue Agent then has to write a confidential report to uphold the 50 per cent fraud penalty.

Q. Is that true of all Internal Revenue Agents involved in a proper case, and not limited to members of the Fraud Squad? A. That is right.

Q. The Fraud Group? A. That is right.

Q. In a case where an ordinary, garden-variety Internal Revenue Agent finds evidence in a criminal case, doesn't he also submit such evidence or a summary of such evidence in his report to his superior?

A. He writes an information report giving in detail all that he has found during the course of his investigation.

Q. Which may include evidence which would point toward a criminal case?

A. That is right. Maybe I should qualify that

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

last statement as to the 50 per cent penalty. Prior to the mimeographed 55-19, fraud cases were always worked in the [22] Fraud Group. If a Special Agent turned them down for prosecution, we would continue on in the Fraud Group to finish the case. Those were the old regulations. Under the new regulations, if the Special Agent turns them down, they go direct to the Field. That is since January 1, 1955.

Q. Mr. Murphy, I will read to you now Section 4566.1 (1) of the Internal Revenue Manual, which provides, and I quote:

“Responsibility in all full-scale investigations for the development of evidence and for recommendations pertaining to the potential criminal features of the case and the ad valorem additions to the tax for civil fraud, negligence, or delinquency (excepting those concerning the tax estimations), shall be that of the Special Agent unless and until he withdraws from the case. He will be responsible for the method of procedure and conduct of the investigation. The cooperating officer will be responsible for the audit features of the case. The Internal Revenue Agent will also be responsible for taking any action necessary to protect the interests of the Government in respect to the statutory period for assessment.” [23]

Are you familiar with that regulation?

A. That regulation came out when 55-19 was put into effect on January 1, 1955.

Plaintiff's Exhibit No. 2—(Continued)

(Deposition of Vincent B. Murphy.)

Q. And prior to that time did matters contained in that regulation cover the respective duties of the Special Agent and Internal Revenue Agent assigned to a case? A. In general, yes.

Mr. Lavine: That is all.

Mr. Machtinger: I would like to ask a question to clarify a point.

Cross Examination

Q. (By Mr. Machtinger): I think you said that prior to 55-19 the Internal Revenue Agent attached to Fraud would continue the investigation, even though the Special Agent had turned it down for criminal purposes? A. That is right.

Q. You mean, of course, he would continue in the civil aspect, and that included the 50 per cent civil fraud penalty? A. Yes.

Q. But no longer the criminal aspect of the case? A. No, sir.

Q. One other question with reference to a question [24] Mr. Lavine asked you:

After a Special Agent comes out, it is at that time that the taxpayer is first fully aware there is an investigation for criminal purposes, isn't that right? A. I think so, yes.

Q. And isn't it true the taxpayer understands the different functions of the Internal Revenue Agent, who may or may not be attached to the Fraud Squad, and the Special Agent, that the Special Agent is there for the criminal aspect of it?

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

A. I don't think the general public know much about the duties of agents.

Q. When the Special Agent is called out and is assigned to the case, isn't the taxpayer then advised of his rights, as far as the criminal features go, and possible prosecution?

A. He is supposed to be, yes.

Q. Until that time he isn't advised of that phase of the case, that possibly he may incriminate himself in particular documents and certain other aspects of the criminal investigation?

A. No, sir.

Q. So far as the primary responsibility between the Special Agent and the Internal Revenue Agent, it is clear between the two of them, isn't it, that the primary responsibility of the Special Agent is for the criminal [25] aspect, and the primary responsibility of the Revenue Agent attached to the Fraud Squad is for giving such technical advice in respect to the audit features as the Special Agent may require or request?

A. That is true.

Mr. Machtinger: I don't have any further questions.

Mr. Lavine: No further questions.

Redirect Examination

Q. (By Mr. Mortenson): Mr. Murphy, does the fact that you might possibly be affected by the results of this action in the Federal Court have

Plaintiff's Exhibit No. 2—(Continued)

(Deposition of Vincent B. Murphy.)

any influence on the answers to the questions you have given today, or will give? A. No, sir.

Q. Now, Mr. Murphy, assume that a Special Agent has been assigned to a case, and the taxpayer has been warned of his Constitutional rights; does the Revenue Agent still pursue his work in the matter of investigating the case? A. Yes, sir.

Q. So that the questions relating to the knowledge of a taxpayer that he is suspected of crime, or his lack of knowledge, would relate to the preliminary investigation, would it not?

A. That's right. [26]

Q. Now, assume we have a situation where there is a double set of books, one of which corresponds to the figures on the tax returns, and the other one showing the actual results of business operations, which I consider to be an ideal fraud situation from the Government's standpoint; who normally would testify in court as to the contents of the books and records and the consequences of the double set of books? A. The Revenue Agents.

Q. Who would be the one, as between the Revenue Agent and the Special Agent, who would secure the books, audit the books, and make a report on such before the case goes to the United States Attorney's office?

A. During the years in question the Revenue Agent, who is usually the first man on the scene.

Q. Now, Mr. Murphy, some questions have been asked about the criminal features and the non-

Plaintiff's Exhibit No. 2—(Continued)

(Deposition of Vincent B. Murphy.)

criminal or audit features of an investigation. Would you classify the work in connection with examining a double set of books a criminal feature or a non-criminal feature of the investigation?

A. The examining of the books?

Q. Yes.

A. Well, I would think if you find two sets of books, and one is false, that that is part of the evidence that is going to be needed for criminal prosecution.

Q. That would be evidence of criminal intent, would it [27] not? A. I would think so.

Q. And it would be the duty of the Revenue Agent to conduct the examination in that regard, is that correct?

A. It is his duty to make an audit of all records.

Q. Do you know of any instances during the time that Mr. Cummins was a Revenue Agent, in which he had practically completed the investigation before a Special Agent was called in?

A. I think there were several cases like that.

Q. With regard to investigations conducted by Assistant United States Attorneys, in your experience what proportion of the evidence used in court would be developed in such manner?

A. Well, I don't know of any case where the evidence was developed. They asked for clarification of evidence or further evidence to prove that evidence. Of course, the duty of a Special Agent

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

was to procure evidence, and there may be cases where they call the Special Agent in.

Q. With regard to the function of the Regional Counsel's office in processing fraud cases, what portion of the evidence, in your experience, would be developed in that office after the case was referred to the Regional Counsel?

A. Well, that I couldn't answer definitely, because I wouldn't be apprized of what the Regional Counsel was [28] doing.

Q. Regarding the fact that a Special Agent is instructed to warn the taxpayer of his Constitutional rights, and the Agent asks for what might be privileged evidence subsequent to that, does the Revenue Agent usually have contact with the taxpayer?

A. Definitely.

Mr. Mortenson: That is all I have.

Mr. Machtinger: May I ask another question or two?

Recross Examination

Q. (By Mr. Machtinger): After the completion of a joint investigation by the Special Agent and the Internal Revenue Agent, does the Internal Revenue Agent write a report which includes a special recommendation as to criminal prosecution?

A. No, sir.

Q. Isn't it only the Special Agent's report which recommends for or against criminal prosecution?

A. Yes, sir.

Q. And that Special Agent's report, if it is ap-

Plaintiff's Exhibit No. 2—(Continued)

(Deposition of Vincent B. Murphy.)

proved, is referred to the Regional Counsel's office, is that correct? A. That is correct.

Q. And no criminal prosecution is commenced unless [29] the Regional Counsel recommends criminal prosecution be commenced against the taxpayer? A. That is right.

Q. So in considering whether there shall or will be criminal prosecution against the taxpayer, the Internal Revenue Agent's report plays no part in the criminal aspects of the case?

Mr. Mortenson: Just a minute.

Mr. Machtinger: I will withdraw that. No further questions.

Mr. Lavine: No further questions.

Redirect Examination

Q. (By Mr. Mortenson): I don't know whether this is a question which you can answer, Mr. Murphy, but do you know whether it would be the duty of a Revenue Agent to report evidence of a crime against the Revenue Act to the local United States Attorney, in the event a Special Agent arbitrarily refused to recommend prosecution?

Mr. Machtinger: May I ask Mr. Mortenson to define the word "duty," whether it is duty within the scope or functions of the employee, or duty as a citizen?

Mr. Mortenson: I intended that to mean a statutory duty. [30]

Plaintiff's Exhibit No. 2—(Continued)
(Deposition of Vincent B. Murphy.)

Mr. Machtinger: As distinguished from a duty within the scope of the employment of the Internal Revenue Agent?

Mr. Mortenson: No, in connection with his employment as an Internal Revenue Agent. That is a matter of law, and probably is an improper question.

Mr. Machtinger: Do you withdraw the question? If not, I think we should object to it, because I don't think a witness such as Mr. Murphy could testify with reference to——

Mr. Lavine: Well, of course any objections are reserved until the time of trial.

Mr. Mortenson: No further questions.

Mr. Lavine: No further questions.

/s/ VINCENT B. MURPHY,
Signature of Witness.

Subscribed and sworn to before me this 17th day of October, 1956.

[Seal] /s/ VOLNEY V. BROWN, JR.,
Notary Public, County of Los Angeles, State of California.

[Endorsed]: Filed October 19, 1956.

PLAINTIFF'S EXHIBIT No. 3

United States Civil Service Commission

Washington 25, D. C.

October 10, 1956

Address Only "Civil Service Commission." In
Your Reply Refer to File BAR:EPT:rsp, and
Date of This Letter CSA-380 606.

Airmail

Mr. Oren E. Cummins

918 Encanto Drive

Arcadia, California

Dear Mr. Cummins:

Your appeal to the Commission from the determination by the Retirement Division that your application for benefits under Section 1 (d) of the Civil Service Retirement Act may not be accepted has been referred to this Board for final decision.

The Board of Appeals and Review has made a study of the facts in your case. Section 1(d) of the Retirement Act provides that any officer or employee to whom this Act applies the duties of whose position are primarily the investigation, apprehension or detention of persons suspected or convicted of offenses against the criminal law of the United States (including any officer or employee engaged in such activity who has been transferred to a supervisory or administrative position) who is at least 50 years of age, and who has rendered 20 years of service or more in the performance of

Plaintiff's Exhibit No. 3—(Continued)

such duties (including the duties of a supervisory or administrative officer or employee) may on his own application and upon the recommendation of the head of the department or agency in which he is serving and with the approval of the Civil Service Commission retire under the provisions of this Section. Recommendation of the head of the department or agency in which the employee is serving is required and since the Treasury Department has not submitted such recommendation the statutory provisions of Section 1(d) of the Act preclude the acceptance of your application for benefits thereunder. Accordingly, the decision reached by the Retirement Division in your case is affirmed.

For the Commissioners:

Sincerely yours,

/s/ JOHN E. BLANN,

John E. Blann, Chairman,

Board of Appeals and Review.

PLAINTIFF'S EXHIBIT No. 4

Office of Commissioner of Internal Revenue

Address Reply to Commissioner of Internal Revenue and refer to A:PT:PO.

May 2, 1955

Mr. O. E. Cummins
918 Encanto Drive
Arcadia, California

Plaintiff's Exhibit No. 4—(Continued)

Dear Mr. Cummins:

Commissioner Andrews has asked me to reply to your letter of April 11, 1955, concerning your eligibility for retirement under Section 1(d) of the Retirement Act.

You have no appeal to the Civil Service Commission since retirement under Section 1(d) must be recommended by the head of the agency. It is not a right to which an employee becomes entitled by virtue of specific service but is discretionary with the Secretary of the Treasury.

Your case has received careful consideration but evidence has not been presented to conclusively prove that you performed the duties of a Special Agent, which is a position approved for coverage under Section 1(d). Therefore, we have no basis for ruling favorably on your appeal.

Your final appeal is to the Director of Personnel, Treasury Department. In your letter of March 21, 1955, you stated that you have information that Revenue Agents have retired under Section 1(d). In order that we may have the file complete, please furnish us with the names of these Revenue Agents. When we have this information, we will submit the entire file to the Treasury Department.

Very truly yours,

/s/ M. LATHAM, JR.,

(Acting) Director, Personnel
and Training Division.

PLAINTIFF'S EXHIBIT No. 5

U. S. Treasury Department

Washington 25

February 7, 1955

Office of Commissioner of Internal Revenue

Address Reply to Commissioner of Internal Revenue and Refer to A:PT:PO.

Mr. Oren E. Cummins

918 Encanto Drive, Arcadia, California

Dear Mr. Cummins:

This refers to your letter concerning your eligibility for retirement under Section 1(d) of the Retirement Act.

The Treasury Department negotiated with the Civil Service Commission a list of positions approved for inclusion under Section 1(d). The duties of such positions had to be within the scope of standards furnished by the Civil Service Commission. The position of Internal Revenue Agent, GS-512, in the Audit Division has not been approved for coverage; the position of Special Agent (Tax Fraud), GS-1811, in the Intelligence Division is, however, covered.

As you requested, I am enclosing a list of the positions which have been approved by the Civil Service Commission.

Very truly yours,

/s/ M. J. FLATTERY,

M. J. Flattery, Chief, Placement Branch, Personnel and training Division.

Enclosure

PLAINTIFF'S EXHIBIT No. 6

U. S. Treasury Department
Washington 25
April 5, 1955

Office of Commissioner of Internal Revenue

Address Reply to Commissioner of Internal Revenue and Refer to A:PT:PO.

Mr. O. E. Cummins
918 Encanto Drive
Arcadia, California

Dear Mr. Cummins:

This refers to your letter of March 21, 1955, addressed to Commissioner Andrews, with enclosures, concerning your desire to establish creditability of service for retirement under Section 1(d) of the Retirement Act.

It is mandatory that an employee occupy a position approved for coverage under Section 1(d) at the time he retires in order to have his annuity computed under its provisions. If an employee occupying a covered position needs time spent on detail from an uncovered position to a covered position to make up the necessary twenty years, such time spent on detail is creditable if properly documented.

Since the position of Internal Revenue Agent, which you occupied at the time you retired, is not approved for inclusion under Section 1(d), you are not, in any case, eligible to have your retirement annuity computed under the provisions of

Plaintiff's Exhibit No. 6—(Continued)
this Section. I am sorry, but we are unable to
take any action in your case.

Very truly yours,

/s/ M. J. FLATTERY,

M. J. Flattery, Chief, Placement Branch, Person-
nel and Training Division.

PLAINTIFF'S EXHIBIT No. 7

(Copy)

PENALTY CASES

Page 8

Especially in fraud cases the investigation should be thorough and complete in every detail and the examining officer should arm himself with knowledge of every phase of the case for the further reason that he should be prepared to be an intelligent witness for the Government in the event of subsequent litigation, either in a civil trial before the Board of Tax Appeals in connection with the determination of penalty liability or in a criminal trial before the United States Federal Courts.

[Endorsed]: No. 16005. United States Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. Oren E. Cummins, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: May 7, 1958.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16005

UNITED STATES OF AMERICA, Appellant,

vs.

OREN E. CUMMINS,

Appellee.

STATEMENT OF POINTS

Appellant, the United States of America, will rely upon the following points in its appeal in the above case:

1. The district court erred in granting a money judgment for appellee for monies allegedly due him under the provisions of 5 U.S.C. 691(d).

2. The district court erred in holding that appellee at the time of his retirement had satisfied all of

the requirements for retirement under 5 U.S.C. 691(d).

3. The district court erred in holding that appellee is entitled to have his annuity computed under 5 U.S.C. 691(d).

4. The district court erred in holding that the refusal of the Secretary of the Treasury and the Civil Service Commission to grant appellee's retirement under 5 U.S.C. 691(d) was due to an erroneous interpretation of that Section.

5. The district court erred in holding that in the performance of his duties appellee was subjected to a degree of hazard as great or greater than the degree of hazard to which the Special Agent with whom he conducted investigations was subjected.

6. The district court erred in holding that appellee was subjected to a degree of hazard contemplated by 5 U.S.C. 691(d).

7. The district court erred in failing to dismiss the action for lack of jurisdiction.

8. The district court erred in holding that the Secretary improperly refused to recommend appellee for retirement under this Section.

9. The district court erred in holding that the Civil Service Commission improperly denied appellee retirement benefits under 5 U.S.C. 691(d).

10. The district court erred in holding that the Secretary of the Treasury and the Civil Service Commission negotiated a list of positions covered

by this Section because of an erroneous interpretation of the Statute.

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Certificate of Service Attached.

[Endorsed]: Filed May 12, 1958. Paul P. O'Brien, Clerk.

No. 16005

In the United States Court of Appeals
for the Ninth Circuit

UNITED STATES OF AMERICA, APPELLANT

v.

OREN E. CUMMINS, APPELLEE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL
DIVISION

BRIEF FOR APPELLANT

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INDEX

Jurisdictional statement	Page (i)
Statement of facts	2
Statutes involved	4
Specification of errors	6
Argument:	
The district court should have dismissed appellee's suit for failure to state a claim upon which relief could be granted	8
A. Appellee's failure to obtain the recommendation of the Secretary of the Treasury precludes his claim for retirement benefits under Section 1(d) of the Retirement Act	8
1. The retirement benefits of Section 1(d) are to be allowed only in the discre- tion of the head of the employee's agency	8
2. Since the appellee was not recommended by the Secretary of the Treasury for retirement under Section 1(d), the dis- trict court should have dismissed his claim for the benefits of that Section..	15
B. The district court erred in awarding appellee Section 1(d) benefits on the ground that he was denied them because of an erroneous interpretation of the statute	18
1. Neither the Secretary of the Treasury nor the Civil Service Commission misinter- preted the statute in denying appellee's retirement under Section 1(d).....	19
2. If appellee was denied Section 1(d) bene- fits because of a misinterpretation of the statute, he must in the circum- stances of this case seek relief solely through a mandamus action brought in the District of Columbia	24
Conclusion	28
Table of Exhibits required by subdivision 2(f) of Rule 18....	29

Cases:

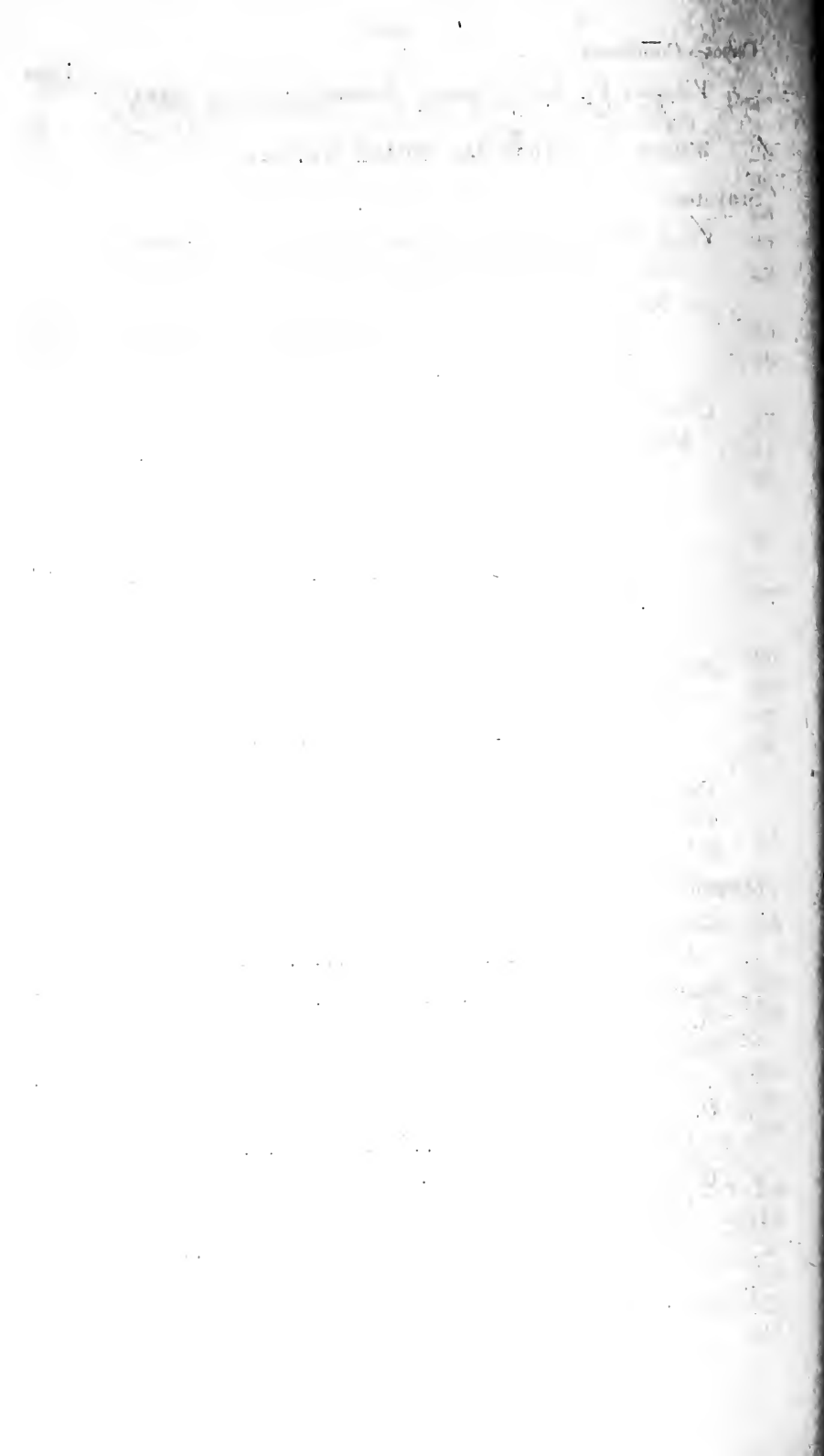
	Page
<i>Adcox Schools v. Administrator of Veterans Affairs</i> , 217 F. 2d 54 (C.A. 9)	26
<i>Amchanitzky v. Sinnott</i> , 69 F. 2d 97 (C.A. 2)	26
<i>Bath County v. Amy</i> , 13 Wall. 244	26
<i>Blackmar v. Guerre</i> , 342 U.S. 512	26
<i>Brown v. Duchesne</i> , 19 How. 183	22
<i>Covington & Cincinnati Bridge Co. v. Hagar</i> , 203 U.S. 109	26
<i>Dismuke v. United States</i> , 297 U.S. 167	15, 18
<i>Federal Communications Commission v. Pottsville Broadcasting Co.</i> , 309 U.S. 134	27
<i>Gibney v. United States</i> , 146 F. Supp. 135 (S.D. Calif.) ..	17, 24
<i>Great Northern Ry. Co. v. United States</i> , 315 U.S. 262 ..	22
<i>Interstate Commerce Commission v. Humboldt S.S. Co.</i> , 224 U.S. 474	27
<i>Interstate Commerce Commission v. United States ex rel. Campbell</i> , 289 U.S. 385	27
<i>Knapp v. Lake Shore & Michigan Southern Ry. Co.</i> , 197 U.S. 536	26
<i>McClung v. Silliman</i> , 6 Wheat. 598	26
<i>McIntire v. Wood</i> , 7 Cranch 503	26
<i>Marshall v. Crotty</i> , 185 F. 2d 622 (C.A. 1)	26
<i>Martin v. Mott</i> , 12 Wheat. 19	16
<i>Norwegian Nitrogen Products Co. v. United States</i> , 288 U.S. 294	13
<i>Palmer v. United States</i> , 129 C. Cls. 322, 121 F. Supp. 643	17
<i>Panama Canal Co. v. Grace Line, Inc.</i> , 356 U.S. 309	16
<i>Petrowski v. Nutt</i> , 161 F. 2d 938 (C.A. 9), certiorari denied, 333 U.S. 842	26
<i>Rosenbaum v. Bauer</i> , 120 U.S. 450	26
<i>Stevenson v. Holstein-Friesian Ass'n.</i> , 30 F. 2d 625 (C.A. 2)	26
<i>Tiger v. Western Investment Co.</i> , 221 U.S. 286	22
<i>Truth Seeker Co. v. Durning</i> , 147 F. 2d 54 (C.A. 2)	26
<i>United States v. Citizens Loan & Trust Co.</i> , 316 U.S. 209	13
<i>United States v. Geo. S. Bush & Co., Inc.</i> , 310 U.S. 371 ..	16
<i>United States v. Hutcheson</i> , 312 U.S. 219	22
<i>United States v. Madigan</i> , 300 U.S. 500	13
<i>United States v. Plesha</i> , 352 U.S. 202	22
<i>United States ex rel. Dunlap v. Black</i> , 128 U.S. 40	27

Cases—Continued

	Page
<i>Virginia Ry. Co. v. System Federation No. 40</i> , 300 U.S. 515	27
<i>Wilbur v. United States</i> , 281 U.S. 206.....	27

Statutes:

Civil Service Retirement Act of 1930, as amended, 5 U.S.C. 691(d). (1952 ed.):	
Section 1(d)	2, 3, 4, 6, 8, 9, 10, 11, 13, 14, 15, 16, 17, 18, 19, 20, 21, 23, 24, 25, 26, 27
Section 4(a), 5 U.S.C. 715	3, 9
Civil Service Retirement Act Amendments of 1956, P. L. 854, 70 Stat. 736 <i>et seq.</i> :	
Section 6(c) (5 U.S.C. (1952 ed., Supp. V) 2256(c))	5, 6, 21, 22, 23, 27
Section 6(d) (5 U.S.C. (1952 ed., Supp. V) 2256(d))	21
Section 403 (5 U.S.C. (1952 ed., Supp. V) 2251, note)	21
Judiciary Act of 1789, 1 Stat. 78, 81-82, now 28 U.S.C. 1332, 1345, 1651:	
Section 11	26
Section 14	26
Public Law 168, 61 Stat. 307, 80th Cong., 1st Sess.....	9, 10, 11
Public Law 879, 62 Stat. 1221, July 2, 1948.....	11
5 U.S.C. 709.....	13
Miscellaneous:	
Civil Service Commission Federal Personnel Manual R-5-36	12
Rule 81(b), F.R.C.P.	26
H. Rep. 2034, 80th Cong., 2d Sess.	24
Senate Report 2642, 84th Cong., 2d Sess., on H.R. 7619, p. 7	22
U. S. Code Congressional Service, 80th Cong., 1st Sess., 1947, p. 1277	10
U. S. Code Congressional Service, 80th Cong., 2d Sess., 1948:	
p. 2275	11, 24
p. 2276	24
p. 2281	11



**In the United States Court of Appeals
for the Ninth Circuit**

No. 16005

UNITED STATES OF AMERICA, APPELLANT

v.

OREN E. CUMMINS, APPELLEE

*ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL
DIVISION*

BRIEF FOR APPELLANT

JURISDICTIONAL STATEMENT

This is an appeal from a judgment entered on December 13, 1957 by the United States District Court for the Southern District of California (Tolin, J.) granting judgment to the appellee for \$760 as retirement benefits due to him under the provisions of 5 U.S.C. 691(d). The district court's jurisdiction was based on 28 U.S.C. 1346(a)(2). The United States filed notice of appeal on February 6, 1958 (R. 30), time for docketing the record on appeal was extended by order of the district court to May 7, 1958 and the case was docketed in this Court on that date (R. 31, 142). This Court's jurisdiction rests upon 28 U.S.C. 1291.

STATEMENT OF FACTS

Appellee, Oren E. Cummins, was employed by the Internal Revenue Service as an Internal Revenue Agent from March 26, 1928 to November 30, 1954, when he reached the mandatory retirement age of 70 years (R. 44). As an Internal Revenue Agent, appellee had since October 1928, been assigned to the "Fraud Group," with the duty of making joint investigations, with Special Agents of the Internal Revenue Service Intelligence Unit, of suspected violations of the criminal provisions of the Internal Revenue Code (R. 20, 44, 47-53).

Appellee on October 18, 1954, made application for retirement under former Section 1(d) of the Civil Service Retirement Act, 5 U.S.C. 691(d) (1952 ed.), *infra*, pp. 4-5, which provided particularly liberal benefits for persons eligible for retirement under that Section. The requirements for such eligibility, as set forth in the statute, are met by an officer or employee who (1) has performed certain hazardous duties as there defined for a period of at least twenty years; (2) is at least fifty years old; and (3) whose application for retirement under Section 1(d) has received the recommendation of the head of his department or agency, and the approval of the Civil Service Commission. The statute does not set any criteria for the granting or withholding of the recommendation of the head of the agency or department involved, but provides that upon such recommendation, the Civil Service Commission shall determine whether the officer or employee is entitled to retirement under Section 1(d). The Civil Service Commission, in making such determination, is required to give full consideration to the degree of hazard to which the officer or employee is

subjected in the performance of his duties, rather than the general duties of the class of his position.

The Secretary of the Treasury refused to recommend appellee for retirement under Section 1(d) (R. 138-141), and in the absence of such recommendation, the Civil Service Commission advised appellee that there was no authority for his retirement under that Section (R. 136-137). His retirement benefits were therefore computed under the general retirement provisions of Section 4(a) of the Act.

Appellee then brought this action in the court below (R. 3-6, 9-12), seeking in his amended complaint to recover the \$76 per month difference between the amount to which he would have been entitled if he had been retired under Section 1(d) of the Retirement Act, and the amount he had actually received since his retirement on November 30, 1954 under Section 4(a) of the Act (R. 11-12). He also prayed for a judgment declaring that he was entitled to be retired under Section 1(d) (R. 12). The district court, after a hearing, held that it had no jurisdiction to award declaratory relief in this case, but awarded a money judgment to appellee in the sum of \$760, representing \$76 per month for the ten months from December 1, 1954 to and including September 1955, the date of the filing of the complaint.

The court found (R. 20, 21-22, 27) that appellee met the requirements for retirement under Section 1(d) with respect to age, length of service, and type of work, and specifically, that appellee "in the performance of his duties was subjected to a degree of hazard contemplated by Section 1(d)" (R. 27). The court found, however, that the Secretary of the Treasury, in refusing to recommend appellee for Section 1(d) retirement,

had not considered the type of duties performed by appellee individually nor the degree of hazard to which he was individually subjected in the performance of these duties (R. 25-26). Instead, the court held, the Secretary had negotiated with the Civil Service Commission a list of positions which would be eligible for retirement under Section 1(d), and the Secretary had withheld his recommendation for appellee's retirement under this Section on the ground that, at the time of his retirement, appellee was not classified in one of these negotiated positions (R. 22-26).

On the basis of these and related findings, the court held (R. 27-28) that at the time of his application for retirement, appellee "had satisfied all of the requirements for retirement under Section 691(d) of Title 5, USCA and is entitled to have his annuity computed under said Section." The court stated (R. 28) that Congress had intended each application for retirement to be considered on its merits without regard to the particular title of the position held, and concluded (R. 28) that the "failure of the Secretary of the Treasury and the Civil Service Commission to grant [appellee's] retirement under Section 691(d) was due to an erroneous interpretation of said Section in that the refusal of such retirement was based upon a classification of positions which had been set up contrary to the provisions of said Section."

STATUTES INVOLVED

Former Section 1(d) of the Civil Service Retirement Act of 1930, as amended, 5 U.S.C. 691(d) (1952 ed.) provided as follows at the time of appellee's retirement:

Any officer or employee * * * the duties of

whose position are primarily the investigation, apprehension, or detention of persons suspected or convicted of offenses against the criminal laws of the United States (including any officer or employee engaged in such activity who has been transferred to a supervisory or administrative position) who is at least fifty years of age, and who has rendered twenty years of service or more in the performance of such duties (including the duties of a supervisory or administrative officer or employee) may, on his own application and upon the recommendation of the head of the department or agency in which he is serving, and with the approval of the Civil Service Commission, retire from the service; and the annuity of such officer or employee shall be equal to 2 per centum of his average basic salary for any five consecutive years of allowable service at the option of such officer or employee, multiplied by the number of years of service, not exceeding thirty years. The Civil Service Commission shall, upon recommendation by the head of the department or agency involved, determine whether such officer or employee is entitled to retirement under this subsection. In making such determination, the Commission shall give full consideration to the degree of hazard to which such officer or employee is subjected in the performance of his duties, rather than the general duties of the class of the position held by such officer or employee.

Present Section 6(c) of the Civil Service Retirement Act of 1930, as amended, and as renumbered by the Civil Service Retirement Act Amendments of 1956, 70 Stat.

744, 5 U.S.C. 2256(c) (1952 ed., Supplement V), which replaced former Section 1(d) and became effective on October 1, 1956, provides in pertinent part as follows:

Any employee the duties of whose position are primarily the investigation, apprehension, or detention of persons suspected or convicted of offenses against the criminal laws of the United States, including any employee engaged in such activity who has been transferred to a supervisory or administrative position, who attains the age of fifty years and completes twenty years of service in the performance of such duties may, if the head of his department or agency recommends his retirement and the Commission approves, voluntarily retire from the service and be paid an annuity computed as provided in [Section 9 of the Act]. The head of the department or agency and the Commission shall give full consideration to the degree of hazard to which such employee is subjected in the performance of his duties, rather than the general duties of the class of the position held by such employee. * * *

SPECIFICATION OF ERRORS

1. The district court erred in granting a money judgment for appellee for monies allegedly due him under the provisions of 5 U.S.C. 691(d).
2. The district court erred in holding that appellee at the time of his retirement had satisfied all of the requirements for retirement under 5 U.S.C. 691(d).
3. The district court erred in holding that appellee is entitled to have his annuity computed under 5 U.S.C. 691(d).

4. The district court erred in holding that the refusal of the Secretary of the Treasury and the Civil Service Commission to grant appellee's retirement under 5 U.S.C. 691(d) was due to an erroneous interpretation of that Section.

5. The district court erred in holding that in the performance of his duties appellee was subjected to a degree of hazard as great or greater than the degree of hazard to which the Special Agent with whom he conducted investigations was subjected.

6. The district court erred in holding that appellee was subjected to a degree of hazard contemplated by 5 U.S.C. 691(d).

7. The district court erred in failing to dismiss the action for lack of jurisdiction.

8. The district court erred in holding that the Secretary improperly refused to recommend appellee for retirement under this Section.

9. The district court erred in holding that the Civil Service Commission improperly denied appellee retirement benefits under 5 U.S.C. 691(d).

10. The district court erred in holding that the Secretary of the Treasury and the Civil Service Commission negotiated a list of positions covered by this Section because of an erroneous interpretation of the Statute.

ARGUMENT

The District Court Should Have Dismissed Appellee's Suit for Failure to State a Claim Upon Which Relief Could Be Granted

A. Appellee's Failure to Obtain the Recommendation of the Secretary of the Treasury Precludes His Claim for Retirement Benefits Under Section 1(d) of the Retirement Act.

1. *The retirement benefits of Section 1(d) are to be allowed only in the discretion of the head of the employee's agency.* Former Section 1(d) of the Civil Service Retirement Act, 5 U.S.C. 691(d) (1952 ed.) (*supra*, pp. 4-5), under which appellee sought to retire, expressly vests in the head of the employing agency complete discretion to determine whether an employee will be considered for retirement under that Section. The statute provides that a Government employee whose duties are primarily investigatory and who is at least fifty years old and has rendered at least twenty years of service in the performance of such duties "may, on his own application and upon the recommendation of the head of the department or agency in which he is serving, and with the approval of the Civil Service Commission, retire from the service * * *." The statute spells out the method of computing the annuity payable to such an employee, and then provides:

The Civil Service Commission shall, upon recommendation by the head of the department or agency involved, determine whether such officer or employee is entitled to retirement under this subsection. In making such determination, the

Commission shall give full consideration to the degree of hazard to which such officer or employee is subjected in the performance of his duties, rather than the general duties of the class of the position held by such officer or employee.

Thus, Section 1(d) on its face makes perfectly clear that its special retirement provisions can only apply to an otherwise eligible employee where the head of the agency so recommends; in the absence of such a recommendation, the employee has no right whatever to the benefits of the Section.

a. The reason for this requirement becomes immediately apparent upon examination of the history and purpose of Section 1(d). This Section is part of the Civil Service Retirement Act of 1930, 5 U.S.C. 691 *et seq.*, dealing generally with retirement of civil service employees. As originally enacted the Retirement Act sought, *inter alia*, to provide for the voluntary retirement of employees of a certain age who had served a minimum number of years (5 U.S.C. 691) and the compulsory retirement of persons who, by reason of age, were no longer able to render satisfactory service (5 U.S.C. 715). The latter provision required the retirement on an annuity of any employee who had completed fifteen years of service and had reached his seventieth birthday. In 1947, Congress amended the Retirement Act to provide for the *voluntary* retirement "on his own application and with the consent of the Attorney General * * *" of any special agent or other investigation employee of the Federal Bureau of Investigation who was at least fifty years of age and had rendered twenty years or more of service in such capacity. Public Law 168, 61 Stat. 307, 80th

Cong., 1st Sess.¹ The object of this amendment was to allow, *with the consent of the Attorney General*, men in that service to retire earlier in order that younger men might be induced to enter it. See U.S.C. Congressional Service, 80th Cong., 1st Sess., 1947, p. 1277. A more liberal method of computing the annuity in such instances was provided in order to prevent an economic hardship on the employee and to provide an incentive for the employee to accept earlier retirement. Thus the Attorney General was able, when he felt the bureau needed younger men to perform its duties more effectively, to offer to its older employees the opportunity to retire under the provisions of this Act. The statute, however, created no *right* in the agents to such retirement; by its terms the Attorney General was not obligated to retire F.B.I. employees merely because they met the age and length of service requirement, but was expressly given the authority to allow their retirement in his discretion.

In 1948, Congress extended these special retirement provisions to other Government agencies employing personnel engaged primarily in law enforcement. The

¹ Public Law 168 provided:

Section 1(b) of the Civil Service Retirement Act of May 29, 1930, as amended, is amended by adding at the end thereof the following new subsection:

(i) Any special agent, special agent in charge, inspector, Assistant Director, assistant to the Director, Associate Director, or the Director, who is at least fifty years of age and who has rendered twenty years of service or more as a special agent, or as aforesaid above, in the Federal Bureau of Investigation may, on his own application and *with the consent of the Attorney General*, retire from the service and such annuity of such employee shall be equal to 2 per centum of his average basic salary for the five years next preceding the date of his retirement, multiplied by the number of years of service, not exceeding thirty years. [Emphasis supplied.]

1948 amendment, which introduced the change upon which appellee here bases his claim, likewise restricted its benefits to those employees who secured "the recommendation of the head of the department or agency" in which they were serving. 5 U.S.C. 691(d), *supra*, p. 5. The legislative history of this amendment, as well as its language, establishes that, as in the original provision, this privilege of early retirement was not given as an absolute right to the employee, but was wholly dependent upon the decision of his agency head, who presumably would consider such factors as the agency's need for younger men in its more hazardous positions.² In short, the purpose of the Act, as demonstrated throughout its history, is not primarily to confer any benefit upon employees within its coverage, but rather to enable the Government agencies involved, by selective use of these special benefits, to maintain a force of relatively younger men more capable of performing the hazardous duties to which the Act refers. Unlike other retirement provisions, which are primarily intended for the benefit of the employees themselves, retirement under Section 1(d) remains, in

² See U.S. Code Congressional Service, 80th Cong., 2d Sess., 1948, p. 2275. Moreover, this legislative history strongly indicates that Internal Revenue Agents were not contemplated as coming within the meaning of the provision. Thus, while some of the suggested drafts of bills to amend Public Law 168 followed the form of that law and specified which employees could be retired under this special provision, none of them specified Internal Revenue Agents. See, *e.g.*, the employees listed in the draft on p. 2281 of U.S. Code Congressional Service, 1948, *supra*. The bill as it was finally enacted, Public Law 879, 62 Stat. 1221, July 2, 1948, deleted all reference to which employees could be retired under the Act and entrusted to the Civil Service Commission the determination whether employees, who had been recommended for such retirement by their agency heads, in fact had performed duties which fall within the purview of the statute.

the first instance, a matter for the agency head himself, as an important administrative tool in maintaining the efficiency of the service; and the employee himself therefore has no vested right to these benefits. As the Civil Service Commission points out in its Federal Personnel Manual:

The legislative history of this provision shows that its purpose is to allow the earlier retirement of certain employees whose duties are primarily the investigation, apprehension, or detention of persons suspected or convicted of offenses against the criminal laws of the United States who, because of the physical requirements of their positions and the hazardous activities involved, are no longer capable of carrying on efficiently. Their replacement by younger men would improve the service. A more generous method of computing the amount of annuity is provided, not as a special reward for the type of service involved, but rather because a more liberal formula is usually necessary to make the earlier retirement (with resultant shorter service) economically possible.

The agency head's recommendation for retirement under this provision is discretionary, and the law does not require him to recommend retirement merely because the employee meets the age and service requirements. He should exercise his discretion to recommend favorably only when he determines that the public interest would be best served by the employee's retirement with annuity computed under the generous formula applicable.

* * *³

³ Civil Service Commission Federal Personnel Manual R-5-36. Since the Civil Service Commission is charged with the re-

b. The foregoing discussion of the history and purpose of Section 1(d), as well as the language of the statute itself, makes clear that no matter how well qualified with respect to the other statutory requirements an employee may be, he nevertheless cannot be approved by the Civil Service Commission for retirement under this provision unless he has also received the recommendation of his agency head. Thus the statutory language not only requires both the recommendation of the employing agency and the approval of the Civil Service Commission as independent and equally necessary prerequisites to Section 1(d) retirement⁴ but leaves no doubt as to the difference between the functions of the two agencies in effecting an employee's retirement under the Section. On the one hand, the statute sets no objective standard to govern the granting or withholding of the employing agency's recommendation; and in light of our discussion of the purpose of the Act, *supra*, pp. 10-12, it is perfectly clear that this was deliberately done to permit the agency head himself to make this determination on the basis of his own assessment of the public

sponsibility for the administration of the Federal Retirement Program, including the issuance of regulations and instructions thereunder (5 U.S.C. 709), the agency's interpretation of the statute should, of course, be accorded great weight. *United States v. Citizens Loan & Trust Co.*, 316 U.S. 209, 214; *United States v. Madigan*, 300 U.S. 500, 505. This rule has special applicability where, as here, " * * * it involves a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new." *Norwegian Nitrogen Products Co. v. United States*, 288 U.S. 294, 315.

⁴ The first sentence of the statute provides that an otherwise eligible employee may retire under the Section "upon the recommendation of the head of the department or agency in which he is serving, and with the approval of the Civil Service Commission

* * * ."

interest and the needs of the service, rather than simply in terms of the individual employee's qualifications. Only if the agency head determines to recommend him for 1(d) retirement does the employee then acquire the right to have his personal qualifications for these benefits evaluated by the Civil Service Commission. The statute makes this plain, by expressly providing in its second sentence that the Commission "*shall, upon recommendation by the head of the department or agency involved, determine whether such officer or employee is entitled to retirement under this subsection*" [emphasis supplied]. In determining this entitlement, the Civil Service Commission must, of course, apply the objective statutory criteria with respect to age, length of service, and appropriately hazardous duty, including the admonition in the final sentence of Section 1(d) to "give full consideration to the degree of hazard" to which the individual employee is subjected. But an employee is not entitled to have the Commission even consider these qualifications, let alone approve his retirement under Section 1(d), unless the head of the employing agency has *first* recommended him for these benefits.⁵

⁵ Although the Act was amended in 1956 to require the agency head as well as the Civil Service Commission to consider the degree of hazard to which the individual employee was subjected, we show (*infra*, pp. 21-23), (1) that this new legislation does not apply to the appellee; (2) that it in fact accentuates the extent of the discretion which Section 1(d) vested in the agency head; and (3) that even if this new language did apply to appellee, it would still not require his agency head to recommend him merely because he was engaged in performing hazardous duties. Both the old and the new statutes, as we show, leave the agency head with full discretion to withhold his recommendation if, in his view, the needs of the service or other such factors so indicate.

2. *Since the appellee was not recommended by the Secretary of the Treasury for retirement under Section 1(d), the district court should have dismissed his claim for the benefits of that Section.* As we have shown, *supra*, pp. 8-14, the recommendation of the head of the employee's agency is a statutory requisite for retirement under Section 1(d) of the Retirement Act. Since the Secretary of the Treasury, as head of the agency where appellee was employed, refused to recommend him for such benefits, the district court plainly should have dismissed his complaint for failure to state a claim upon which relief could be granted. For, although a district court in a suit under the Tucker Act has jurisdiction over a claim for an annuity, *Dismuke v. United States*, 297 U.S. 167, the Supreme Court has made clear that the court can only grant relief where the administrative denial of the benefit turned upon a pure question of law. "[T]he power of the administrative officer will not, in the absence of a plain command, be deemed to extend to the denial of a right which the statute creates, and to which the claimant, upon facts found or admitted by the administrative officer, is entitled." *Id.* at 172. A different rule applies, however, in cases where the authority to decide whether the claimant shall receive the benefit is by statute conferred upon an administrative officer. "If the statutory benefit is to be allowed only in his discretion, the courts will not substitute their discretion for his." *Ibid.*

a. This principle of the *Dismuke* case is not, of course, novel doctrine; for more than a century, the Supreme Court has consistently recognized that administrative discretion in such matters is not for

judicial review.⁶ Thus, in *United States v. Geo. S. Bush & Co., Inc.*, 310 U.S. 371, 380, Mr. Justice Douglas pointed out:

* * * It has long been held that where Congress has authorized a public officer to take some specified legislative action when in his judgment that action is necessary or appropriate to carry out the policy of Congress, the judgment of the officer as to the existence of the facts calling for that action is not subject to review.* * *

The latest in the long line of cases upholding this doctrine, *Panama Canal Co. v. Grace Line, Inc.*, 356 U.S. 309, again makes clear that while judicial relief is often available in "situations where ministerial duties of a nondiscretionary nature are involved", the courts cannot intervene where "the decision to act or not to act is left to the expertise of the agency burdened with the responsibility for decision." 356 U.S. at 318.

This, of course, is such a case. As we have shown in Point A-1, *supra*, pp. 8-14, the authority to recommend an employee for retirement under Section 1(d) is by statute vested completely in the discretion of the head of the employing agency. The district court has no jurisdiction to substitute its discretion for that of the agency head, nor, since the statute laid down no standards to govern the exercise of this discretion, could the court inquire into the reason why the recommendation

⁶ See, e.g., *Martin v. Mott*, 12 Wheat. 19, 31, where Justice Story stated:

* * * Whenever a statute gives a discretionary power to any person, to be exercised by him, upon his own opinion of certain facts, it is a sound rule of construction, that the statute constitutes him the sole and exclusive judge of the existence of those facts. * * *

had been denied.⁷ Since this recommendation was a *sine qua non* to retirement under Section 1(d), its absence completely precluded the district court from awarding appellee the benefits of this Section. Just as if appellee had failed to meet one of the other statutory requisites, such as age or length of service, so, too, his failure to obtain the recommendation of the Secretary of the Treasury required the district court to dismiss his suit for failure to state a claim upon which relief could be granted.⁸

b. Precisely this result was reached in the only other case to consider this question, *Gibney v. United States*, 146 F. Supp. 135 (S.D. Calif.). The facts in the *Gibney* case were on all fours with those here; Gibney, like Cummins, was an Internal Revenue Agent attached to the Fraud Unit, and when the Secretary of the Treasury refused to recommend him for retirement under Section 1(d), he brought suit for the benefits of that Section. Chief Judge Yankwich, in an extensive and carefully reasoned opinion, sustained the Government's defense that the complaint had failed to state a claim upon which relief could be granted. After analyzing the language and the legislative history of Section 1(d),

⁷ Even if the administrative discretion had been abused, appellee could only challenge its exercise in a mandamus action brought in the District of Columbia. See *infra*, pp. 24-28.

⁸ Cf. *Palmer v. United States*, 129 C. Cls. 322, 121 F. Supp. 643, where a Tucker Act suit for benefits under Section 1(d) of the Retirement Act was predicated upon the allegation that the plaintiff had been improperly transferred from a position within the coverage of the Act after only fifteen years, thus preventing him from obtaining the necessary twenty years of service. The Court of Claims pointed out that any action based upon the allegedly improper transfer was barred by limitations, and held that since plaintiff could not show he had held a covered position for twenty years, his suit must be dismissed for failure to state a claim upon which relief could be granted.

Judge Yankwich found that Congress had made both the recommendation of the head of the employing agency and the approval of the Civil Service Commission "conditions precedent to the granting of voluntary retirement under these more favorable conditions. (146 F. Supp. at 139.) He pointed out (*id.* at 140) that Congress had not "laid down any rules under which the recommendation of the head of the agency shall be granted," and, accordingly, that, under the ruling in *Dismuke v. United States, supra*, the court had no power to question the exercise of administrative discretion in refusing such recommendation.⁹ We submit that Judge Yankwich was clearly correct and that this action, too, should have been dismissed for failure to state a claim upon which relief could be granted.

B. The District Court Erred in Awarding Appellee Section 1(d) Benefits on the Ground That He Was Denied Them Because of an Erroneous Interpretation of the Statute.

As we have shown in our first point, *supra*, pp. 8-18, the failure of the appellee to secure the recommendation of the Secretary of the Treasury for his retirement under Section 1(d) required that his suit be dismissed

⁹ The court also stated, by way of dictum, that since Gibney had not shown that he had performed appropriately hazardous duties, the court could not question the administrative determination "even if the Secretary of the Treasury and the head of the Civil Service Commission, both of whom have their official residence in the District of Columbia, were parties to this action * * *" (146 F. Supp. at 141). We consider the question of jurisdiction over these officials, as well as Judge Yankwich's discussion in the latter part of his opinion (146 F. Supp. at 141-142) as to the validity of the refusal to permit retirement under Section 1(d) of Internal Revenue Agents attached to the Fraud Unit, in our Point B-2, *infra*, pp. 24-28.

for failure to state a claim upon which relief could be granted. Such a recommendation is a condition precedent to entitlement to these benefits, and by statute is to be granted solely in the discretion of the agency head. Since, as we have shown, the district court was without power to interfere in this exercise of administrative discretion, the lack of the required recommendation was fatal to appellee's claim.

Nevertheless, the court below held that appellee was entitled to relief because the refusal of the Secretary of the Treasury to recommend his retirement under Section 1(d), and of the Civil Service Commission to approve such retirement, was based upon an erroneous interpretation of the statute. We submit that the district court was clearly wrong in awarding judgment to the appellee on this basis. As we shall show, *infra*, pp. 19-24, there was in fact no violation of any of the statutory requirements by either the Secretary of the Treasury or the Civil Service Commission. But even if there were a violation of the statutory mandate, we show further, *infra*, pp. 24-28, that in the circumstances here such a violation could be challenged only by a mandamus action in the District Court for the District of Columbia, the only court which could acquire personal jurisdiction over either the Secretary of the Treasury or the members of the Civil Service Commission in their official capacities.

1. *Neither the Secretary of the Treasury nor the Civil Service Commission misinterpreted the statute in denying appellee's retirement under Section 1(d).* The court below based its judgment for appellee on the ground that he had been denied Section 1(d) retirement because of an erroneous interpretation of the statute. The court found that the Secretary of the

Treasury and the Civil Service Commission had refused to grant appellee the benefits of Section 1(d) because he was not employed in a position which the two agencies had approved for entitlement to the provisions of that Section, and held that the determination on this basis violated the statutory mandate to consider the degree of hazard to which the individual employee was subjected in the performance of his duties rather than the general duties of the class of the position which he held. We submit that there is no basis for this conclusion, and that neither of the agencies failed to comply with the requirements of the statute.

a. In the first place, it is obvious that since the appellee had never been recommended for Section 1(d) retirement by the head of his agency, the question of the degree of hazard to which he was subjected in the performance of his duties never even became relevant. The statutory admonition that the degree of hazard be determined on an individual basis does not apply to the head of the employing agency in granting or withholding a recommendation for Section 1(d) retirement; to the contrary, we have shown that Congress has endowed the agency head himself with full discretion to make the initial selection of employees who would be considered for this special retirement. The requirement that individual hazard be considered expressly applies only to the *Civil Service Commission*, in determining the eligibility of an employee who has already received such a recommendation. Section 1(d) provides that once an employee has been recommended for special retirement by the head of his agency, the Commission shall then determine his entitlement thereto; and the statute continues: "In making such determination, *the Commission* shall give full consideration to the degree

of hazard to which such officer or employee is subjected in the performance of his duties * * *.” [Emphasis added.] Manifestly, this requirement has no application to the head of the employing agency, and in no way restricts his discretion in the first instance to grant or withhold his recommendation, in accordance with his own concept of the needs of the service, employee morale, and any other factors which he deems relevant.

b. Subsequent to appellee’s retirement, Section 1(d) was amended and renumbered as Section 6(d) by the Civil Service Retirement Act Amendments of 1956, P.L. 854, 70 Stat. 736, 744, 5 U.S.C. (1952 ed., Supplement V) 2256(c). This statute became effective October 1, 1956, and specifically provided in Section 403 that it would not apply in the case of employees retired or otherwise separated prior to its effective date. See 5 U.S.C. 2251, note (1952 ed., Supplement V). Section 6(c) *supra*, pp. 5-6, provides, as does former Section 1(d), that an employee primarily engaged in law enforcement may obtain special retirement benefits if he receives the recommendation of his agency head and the approval of the Civil Service Commission. Unlike former Section 1(d), however, Section 6(c) requires that *both* “[t]he head of the department or agency and the Commission shall give full consideration to the degree of hazard to which such employee is subjected in the performance of his duties, rather than the general duties of the class of the position held by such employee.”

Although the appellee is not covered by the new Section 6(c), this subsequent legislation throws additional light upon the validity of the administrative action in refusing to recommend him for Section 1(d) benefits. It is, of course, well settled that “[s]ubsequent legis-

lation may be considered to assist in the interpretation of prior legislation upon the same subject.” *Tiger v. Western Investment Co.*, 221 U.S. 286, 309; *Great Northern Ry. Co. v. United States*, 315 U.S. 262, 277; cf. *United States v. Hutcheson*, 312 U.S. 219; *Brown v. Duchesne*, 19 How. 183, 194. Here, as both the new statute and its legislative history make clear, Congress was for the first time placing a condition upon the exercise of the agency head’s previously unfettered discretion to grant or withhold his recommendation for special retirement benefits as he saw fit. The Senate Report on H.R. 7619, the bill which became P.L. 854, expressly stated with respect to the new Section 6(c) (S. Rep. 2642, 84th Cong., 2d Sess., p. 7):

Section 6(c)

Under existing provisions relating to the retirement of employees whose duties are primarily the investigation, apprehension, or detention of persons suspected or convicted of offenses against the criminal laws of the United States, the Civil Service Commission is required to give full consideration to the degree of hazard to which the employee is subjected in the performance of his duties, rather than the general duties of the class of the position held by the employee. Under the bill the head of a department or agency would likewise be required to give consideration to these factors in recommending retirement of an employee under these provisions.

Thus this legislative history leaves no doubt “that Congress thought that it was changing the law by changing the language of the Act,” *United States v. Plesha*, 352 U.S. 202, 208, and that under former Sec-

tion 1(d) the head of the agency was not required even to consider degree of hazard in determining whom to recommend for special retirement.

Moreover, it should be noted that even under the new Section 6(c), the right of the administrator to withhold his recommendation upon some other ground is in no way circumscribed by the statutory admonition to consider the individual degree of hazard to which an applicant was subjected. Thus, an administrator can still determine—and doubtless often does—that even though an individual employee was subjected to considerable hazard, nevertheless the needs of the service or another of the factors which we discussed above (*supra*, pp. 10-12, 14), warrant his withholding his recommendation for this special retirement. Nor is there any reason why he should not determine, on the basis of such factors, to refuse to recommend all the occupants of a given position for special retirement. The statute certainly does not prohibit this, and it is easily conceivable that the needs of the Service might dictate retaining, for example, all Internal Revenue Agents in the fraud group as long as possible.

c. Finally, there is no substance to the court's finding that the Civil Service Commission violated the statutory terms by failing to consider the degree of hazard to which appellee as an individual was subjected. As we have shown, the Civil Service Commission is required to consider the factor of degree of hazard, like those of age and length of service, only where an employee has been recommended for Section 1(d) retirement by his agency head; in the absence of such recommendation, the Civil Service Commission has no authority even to consider whether an employee has satisfied any of these statutory criteria, much less to ap-

prove his retirement under Section 1(d). See *supra*, pp. 13-14. Since the appellee here never received such a recommendation, the Commission was required to refuse his application without reaching any of these other matters. And, as the record makes clear, the Commission did precisely this; its letter to appellee (R. 136-137) unequivocally advised him that his application was being rejected because of his failure to satisfy a condition precedent to such retirement, the recommendation of his agency head. Thus, the Commission never had occasion even to consider the degree of hazard to which appellee had been subjected, and obviously did not deny appellee's application on the basis of such a consideration.¹⁰

2. *If appellee was denied Section 1(d) benefits because of a misinterpretation of the statute, he must in the circumstances of this case seek relief solely through a mandamus action brought in the District of Columbia.* Even if, contrary to the foregoing discussion, the dis-

¹⁰ Even if the appellee had been recommended by the Secretary of the Treasury for Section 1(d) retirement, the Commission could properly have refused to approve his retirement on the basis of the position he held, without violating the statutory admonition to consider the degree of hazard to which the individual employee was subjected. For the legislative history of this provision indicates that it is intended only as a *limitation* upon entitlement to Section 1(d) benefits, and operates to prevent blanket inclusion within the Act of all occupants of any position. See H. Rep. 2034, 80th Cong., 2d Sess., reprinted in U.S. Code Congressional Service, 1948, p. 2275, at 2276. As Judge Yankwich pointed out in the *Gibney* opinion, 146 F. Supp. at 139-140, it would not be arbitrary to classify Internal Revenue Agents attached to the Fraud Unit as not being primarily engaged in enforcement of the criminal law within the meaning of the Act. What the Commission could not do under the language of Section 1(d) would be to *approve* all of the occupants of a position, without considering the degree of hazard to which they were individually subjected; and that question, of course, is not involved here.

trict judge was justified in finding that appellee was denied special retirement benefits because of an erroneous application of Section 1(d), it is clear that the court below was without jurisdiction to award him these benefits. As we have shown, *supra*, pp. 8-18, the failure of appellee to obtain the recommendation of the Secretary of the Treasury was, as a matter of law, fatal to his Tucker Act suit. Accordingly, while he may have a legal remedy if this recommendation was improperly withheld, such a remedy must be pursued by seeking a writ of mandamus in the District Court for the District of Columbia.

a. Even upon appellee's own theory of this case, as adopted by the court below, his suit must be, not for a money judgment for Section 1(d) retirement benefits (for he has never satisfied the statutory requirement of a recommendation for such benefits), but rather an order to compel the Secretary of the Treasury to exercise his discretion in accordance with law. Similarly, any relief to which appellee might be entitled against the Civil Service Commission must likewise be obtained through a personal suit against the Commissioners, themselves, in their official capacity, to compel them to abandon the practice of negotiating with the various agencies' lists of positions to be covered by or excluded from Section 1(d). This is plainly the only manner in which appellee could attack the alleged abuse of administrative discretion which he claims has deprived him of his right to Section 1(d) retirement. Such an action, however, is in the nature of a writ of mandamus, and must therefore be brought in the District of Columbia Circuit, the only court authorized to compel official action through mandatory proceedings. Among the long line of cases so holding, in reliance on

Sections 11 and 14 of the Judiciary Act of 1789 (1 Stat. 78, 81-82, now 28 U.S.C. 1332, 1345, 1651), see, *e.g.*, *McIntire v. Wood*, 7 Cranch 503, 504; *McClung v. Silliman*, 6 Wheat. 598; *Bath County v. Amy*, 13 Wall. 244, 248; *Rosenbaum v. Bauer*, 120 U.S. 450; *Knapp v. Lake Shore & Michigan Southern Ry. Co.*, 197 U.S. 536; *Covington & Cincinnati Bridge Co. v. Hager*, 203 U.S. 109; *Stevenson v. Holstein-Friesian Ass'n.*, 30 F. 2d 625, 626 (C.A. 2); *Truth Seeker Co. v. Durning*, 147 F. 2d 54, 56 (C.A. 2); *Amchanitzky v. Sinnott*, 69 F. 2d 97 (C.A. 2).¹¹

Moreover, since the very administrative officials against whom appellee must seek relief—the Secretary of the Treasury and the members of the Civil Service Commission—are officially domiciled in the District of Columbia, only that District Court can obtain the necessary jurisdiction over them in their official capacities. *Blackmar v. Guerre*, 342 U.S. 512. Thus, whatever the nature of the relief sought by appellee, the fact that, as we have shown, it must be pursued against these officials *eo nomine* requires that his action be brought in the District of Columbia.

b. Even in an action brought in the District Court for the District of Columbia, however, it is plain that appellee would not be able to compel the Secretary of the Treasury to recommend his retirement under Section 1(d). As we have shown (*supra*, pp. 8-14), such a rec-

¹¹ This principle has not been altered by the promulgation of Rule 81(b), F.R.C.P., nor by the codification of Title 28 in 1948. See, *e.g.*, *Petrowski v. Nutt*, 161 F. 2d 938, 939 (C.A. 9), certiorari denied, 333 U.S. 842; *Marshall v. Crotty*, 185 F. 2d 622 (C.A. 1). Nor does the Administrative Procedure Act give the court below jurisdiction to grant such relief; *Blackmar v. Guerre*, 342 U.S. 512, 515-516; *Adcox Schools v. Administrator of Veterans Affairs*, 217 F. 2d 54 (C.A. 9).

ommendation is by law committed to the discretion of the agency head. Mandamus, of course, lies only to compel a ministerial act, *United States ex rel. Dunlap v. Black*, 128 U.S. 40, 48; *Wilbur v. United States*, 281 U.S. 206, 218; *Interstate Commerce Commission v. United States ex rel. Campbell*, 289 U.S. 385, 393-394, and cannot control the exercise of discretion. Accordingly, even a court with necessary jurisdiction could, at most, have required the Secretary to exercise his discretion in accordance with law—*i.e.*, by not denying his recommendation to appellee solely on the basis of an erroneous interpretation of the statute—but could not have assumed to control or guide the exercise of this discretion by requiring the Secretary to grant such recommendation. See *e.g.*, *Federal Communications Commission v. Pottsville Broadcasting Co.*, 309 U.S. 134, 144-145; *Virginia Ry. Co. v. System Federation No. 40*, 300 U.S. 515, 551; *Interstate Commerce Commission v. Humboldt S.S. Co.*, 224 U.S. 474, 485.¹²

In any event, it is clear that the court below had no jurisdiction either to award appellee benefits which by statute are within the discretion of his agency head, or to interfere with the exercise of this discretion. Even if, as appellee contends, he had been denied these benefits because of an erroneous interpretation of the statute, his remedy lies against the administrative officials

¹² Similarly, even under the new Section 6(c), which replaced former Section 1(d) (see *supra*, pp. 21-23), no court could order the Secretary to recommend appellee for special retirement. For although the new statute requires the Secretary, in determining whether to grant his recommendation, to consider the degree of hazard to which the employee was exposed, it clearly does not limit his discretion to deny his recommendation for any other reason to any employee, whether or not he had performed hazardous duties.

themselves, in an action in the District of Columbia, their official domicile. He has sued the wrong defendants in the wrong court, and his action must be dismissed.

CONCLUSION

For the foregoing reasons, we respectfully submit that the judgment below should be reversed.

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APPENDIX

TABLE REQUIRED BY SUBDIVISION 2 (F) OF RULE 18 OF
THE COURT OF APPEALS FOR THE NINTH CIRCUIT

	Identified	Offered	Received in Evidence
Plaintiff's Exhibit 1....	38	38	38
Plaintiff's Exhibit 2....	38	38	38
Plaintiff's Exhibit 3....	40	40	40
Plaintiff's Exhibit 4....	40-41	40-41	41
Plaintiff's Exhibit 5....	41	41	41
Plaintiff's Exhibit 6....	41	41	41
Plaintiff's Exhibit 7....	41	41	41

Page references are to the printed record, indicating points at which exhibits were identified, offered and received in evidence.

17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
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No. 16005

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant.

vs.

OREN E. CUMMINS,

Appellee.

On Appeal From the United States District Court for the
Southern District of California, Central Division.

BRIEF FOR APPELLEE.

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FILED

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TOPICAL INDEX

	PAGE
Jurisdictional statement	1
Statement	1
Statute involved	4
Summary of argument.....	4
Argument	5
The Secretary of the Treasury and the Civil Service Commission negotiated a classification of "covered" positions in defiance of congressional mandate.....	5
The refusal to retire appellee because he was in an unlisted position was a pure error of law.....	6
Appellee has satisfied all requirements for retirement under Section 1(d) and is entitled to a money judgment.....	8
Jurisdiction	10
The failure to act on appellee's request for retirement was based upon an error in law—not an error of fact.....	12
Summary of judgment	14
Conclusion	15

TABLE OF AUTHORITIES CITED

CASES

PAGE

Anderson v. United States, 205 F. 2d 326.....	10, 12, 13, 14
Dismuke v. United States, 297 U. S. 167.....	10, 12

STATUTES

Civil Service Retirement Act, Sec. 1(d).....	
.....	1, 3, 4, 5, 6, 7, 8, 9, 10, 14, 15
United States Code, Title 5 (1952 Ed.), Sec. 691(d).....	1
United States Code, Title 28, Sec. 1291.....	1
United States Code, Title 28, Sec. 1346(a) (2).....	1

TEXTBOOKS

Senate Miscellaneous Reports, p. 1668, 80th Cong., 2d Sess.....	7
United States Code Congressional Service, pp. 2276-2277, 80th Cong., 2d Sess.....	5
United States Code Congressional Service, p. 2279, 80th Cong., 2d Sess.	6
United States Code Congressional Service, p. 2280, 80th Cong., 2d Sess.	6, 9

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BRIEF FOR APPELLEE.

Jurisdictional Statement.

Jurisdiction of the District Court is based on 28 U. S. C. 1346(a)(2) and this Court has jurisdiction under 28 U. S. C. 1291.

Statement.

On October 18, 1954, Appellee Oren E. Cummins made application for retirement under Section 1(d) of the Civil Service Retirement Act, 5 U. S. C. 691(d) (1952 Ed.). It is not disputed that Appellee had satisfied the length of service and age requirements for such retirement, in fact, neither the Secretary of the Treasury nor the Civil Service Commission gave any consideration to such matters. Nor did either the Secretary of the Treasury or the Civil Service Commission consider "the degree of

hazard to which such officer or employee is subjected in the performance of his duties.” On the contrary, on February 7, 1955, the Secretary of the Treasury, by his delegate, informed Appellee as follows:

“This refers to your letter concerning your eligibility for retirement under Section 1(d) of the Retirement Act.

The Treasury Department negotiated with the Civil Service Commission a list of positions approved for inclusion under Section 1(d). The duties of such positions had to be within the scope of standards furnished by the Civil Service Commission. The position of Internal Revenue Agent, GS-512, in the Audit Division [80] has not been approved for coverage; the position of Special Agent (Tax Fraud), GS-1811, in the Intelligence Division is, however, covered.

As you requested, I am enclosing a list of the positions which have been approved by the Civil Service Commission.” [R. 22-23, 139.]

The position of Internal Revenue Agent, GS-512, in the Audit Division is the grade which was occupied by Appellee. The position of Special Agent (tax fraud), GS-1811 in the Intelligence Division is one of the “covered positions.” [R. 24.]

In a letter dated April 5, 1955, the Secretary of the Treasury, by his delegate, informed Appellee as follows:

“It is mandatory that an employee occupy a position approved for coverage under Section 1(d) at the time he retires in order to have his annuity computed under its provisions. If an employee occupying a covered position needs time spent on detail

from an uncovered position to a covered position to make up the necessary twenty years, such time spent on detail is creditable if properly documented.

Since the position of Internal Revenue Agent, which you occupied at the time you retired, is not approved for inclusion under Section 1(d), you are not, in any case, eligible to have your retirement annuity computed under the provisions of this Section. I am sorry, but we are unable to take any action in your case.” (Emphasis supplied.) [R. 24-25, 140.]

In a letter dated March 2, 1955, the Civil Service Commission informed Appellee as follows:

“The office of the Regional Commissioner for the Internal Revenue Service informs us that at the time of your retirement *you were not occupying a position which was approved for inclusion under Section 1(d) of the Retirement Act*, and that no recommendation could therefore be made for your retirement under this Section.

Under the circumstances there is no authority for your retirement under Section 1(d) of the Retirement act.” (Emphasis supplied.) [R. 25.]

The reason, and the sole reason, given by the Secretary of the Treasury and the Civil Service Commission for refusing Appellee’s retirement under Section 1(d), was that *he was not classified in a position approved for inclusion under Section 1(d)*. No consideration was given to Appellee’s personal qualifications for retirement under Section 1(d) but refusal of retirement was predicated entirely on the ground that Appellee was not *classified* in a position where he could be *considered* for retirement under Section 1(d).

Statute Involved.

The statute involved is set out in Appellant's Brief at pages 4-5. We take the liberty of quoting here the last sentence of that section:

“In making such determination, the Commission shall give full consideration to the degree of hazard to which such officer or employee is subjected in the performance of his duties, rather than the general duties of the class of the position held by such officer or employee.”

Summary of Argument.

Appellee contends it was an error of law for the Secretary of the Treasury and the Civil Service Commission to refuse him retirement under Section 1(d) for the reason that his class of position *was not listed* among those negotiated between the Secretary of the Treasury and the Civil Service Commission. Among the letters informing Appellee of the basis for refusing retirement, was one dated February 7, 1955 (*supra*, p. 2) to which the list of “approved” positions was attached. Appellee maintains that the negotiations between the Secretary of the Treasury and the Civil Service Commission concerning such a listing as well as the promulgation of the list, were in direct defiance of legislative command. The wording of Section 1(d) of the Retirement Act makes it abundantly clear that retirement is not to be determined in any case by giving consideration to the class of the position held by the employee. On the contrary, his retirement is to be decided upon the basis of the duties he performed.

ARGUMENT.

The Secretary of the Treasury and the Civil Service Commission Negotiated a Classification of "Covered" Positions in Defiance of Congressional Mandate.

As Appellant has stated in its Brief, the forerunner of Section 1(d) of the Retirement Act was PL-168. (App. Br. 10.) This section applied only to employees of the Federal Bureau of Investigation. Subsequent to the passage of the section, which provided for special benefits for employees of the Federal Bureau of Investigation, the Treasury Department and other departments of the Government indicated to the Congress that they felt it was unfair to give such preference to enforcement officers in only one branch of the Government. When broader legislation was later being considered by the Congress, the Treasury Department took the view that its enforcement officers should be given the same benefits as those employed in the Department of Justice. For example, we find at page 2276 of the United States Code Congressional Service, 80th Cong., 2d Sess., the following statement:

"Representatives of the Treasury Department pointed out that granting special retirement benefits to law enforcement agents in one agency and not to those in other agencies is discriminatory and inequitable."

At this same time the Acting Secretary of the Treasury wrote to the Congressional Committee and stated among other things:

"The Department favors granting of the proposed retirement benefits to investigative and law enforcement personnel of any Federal agency which can present justification therefor as the Treasury has always done." (P. 2277.)

We should note that the Civil Service Commission was in agreement with the Treasury views and sent a letter to the Congressional Committee in which it stated:

“As has been stated on previous occasions, the Commission is not in favor of special legislation for individual groups of employees.” (P. 2279.)

The Refusal to Retire Appellee Because He Was in an Unlisted Position Was a Pure Error of Law.

The most significant part of the legislative history of Section 1(d) of the Retirement Act is that two separate drafts of the amendment were submitted to the House Committee by the Chief of the Retirement Division. One of those drafts specified the groups of officers and employees who would be eligible for retirement under the amendment, that is, it provided for retirement on the basis of classifications or titles. The other draft did not specify the titles or the classifications but provided that the amendment should apply to *all* Federal officers and employees whose primary duties involved the investigation, apprehension or detention of persons suspected or convicted of offenses against the criminal laws of the United States. (U. S. C. Congressional Service, p. 2280.) *This latter draft is the one which became Section 1(d).*

Nothing could be clearer than that Congress intended to prohibit the use of a frozen set of classifications of positions. It rejected the draft that set up the qualifications in terms of duties¹ and passed the Bill which specifically said that “in making such determination the

¹It is significant that the list in this rejected Bill is strikingly similar to the one later promulgated by the Secretary of the Treasury and the Civil Service Commission [R. 23, 24].

Commission shall give full consideration to the degree of hazard to which such officer or employee is subjected in the performance of his duties, *rather than the general duties of the class of a position held by such officer or employee.*" (Emphasis supplied.)

Despite this clear mandate from Congress, the Secretary of the Treasury and the Civil Service Commission agreed upon a list of positions which would be covered, and have refused to consider Appellee for retirement because he was not classified under one of the "covered positions." In doing this it is not contended there was an arbitrary determination of facts on the part of the Government officials, because no facts relating to retirement of Appellee were considered. There was merely an error of law in using a list of positions which had been promulgated contrary to legislative enactment. In other words, the Secretary of the Treasury and the Civil Service Commission erroneously interpreted the statute to mean that they could match titles against job classifications to make a mechanical determination of retirement qualifications.

It might be added that while Section 1(d) uses the word "may" in reference to the discretion of Agency officials, there is indication in the legislative history that the Congress intended the provisions to be mandatory. For example, in Senate Miscellaneous Reports, page 1668, 80th Congress, 2d Session, it is stated as follows:

"The Bill provides that the Head of the Department or Agency *shall* make recommendation to the Civil Service Commission when such officer or employee is entitled to retirement and the Civil Service Commission *shall* determine whether or not he shall receive the benefit." (Emphasis supplied.)

Appellee Has Satisfied All Requirements for Retirement Under Section 1(d) and Is Entitled to a Money Judgment.

We should note again that an Internal Revenue Agent (Special Agent) may be retired under Section 1(d) because he is classified under "Positions Covered by §1(d) Retirement Act" [R. 23, 24] and curiously enough, we find that the "Criminal Assignment Squad, New York" which is part of the internal inspection service of the Treasury Department is classified under the covered positions.

No doubt if thought had been given to inclusion of Internal Revenue Agents of the fraud group, they would have been listed as a covered classification. As the testimony amply proves, an Internal Revenue Agent works jointly with the Special Agent in the investigation of persons suspected of offenses against the criminal tax laws of the United States. Much of the evidence in the case is related to the respective duties of the Special Agent and the Revenue Agent. As we have seen, the Special Agent is classified as being eligible for retirement under Section 1(d) while the Revenue Agent is not. The record makes it patently clear that there is no basis for any such distinction. With respect to the duty to investigate persons suspected of tax crimes there is no evidence that Special Agents are subjected to any greater degree of hazard than Revenue Agents who do only fraud investigations. On the contrary, the only testimony in this regard was to the effect that Revenue Agents were subjected to a greater degree of hazard than the Special Agents. [R. 52, 54, 55, 82, 114, 115, 132.]

At the trial the Government argued that a Revenue Agent could not “primarily” be engaged in the investigation of criminal tax fraud because the Special Agent working with him on the joint investigation was the one primarily engaged in the investigation of tax crimes. As the testimony clearly demonstrates, it is *impossible* under the Treasury Rules and Regulations in force during Appellee’s tenure to convict a person for tax evasion without an investigation and report by a Revenue Agent (or deputy collector) in addition to the work of the Special Agent. In every case of criminal tax fraud, a report and computation by a Revenue Agent is necessary before a recommendation of prosecution can be made. As further indication of the Congressional interpretation of the word “primarily” we find the following statement made in a letter from the Chief of the Retirement Division dated April 19, 1948, to the House Committee of Congress. Employees “such as office deputies, marshals and certain post office inspectors” are not considered to be primarily engaged in the investigation of persons suspected of crimes against the United States. (P. 2280, U. S. C. Congressional Service, 80th Cong., 2d Sess.)

As the record shows, there are only a few fraud groups in the United States with considerably fewer than 100 Internal Revenue Agents assigned to such groups. [R. 47.] That is, in only a few offices of the Internal Revenue Service do any of the Internal Revenue Agents work exclusively on fraud cases. Undoubtedly, if the existence of these special fraud groups had been called to the attention of the Civil Service Commission at the time the classifications were set up, the individuals in this group would have been permitted retirement under Section 1(d).

In offices which have no fraud groups, it is customary to have joint investigations conducted by the Special Agents together with regular Internal Revenue Agents. In this way the average Internal Revenue Agent works very few fraud cases. However, Appellee, because of his assignment to the fraud group, was engaged exclusively in the investigation of persons suspected of criminal evasion of tax. [R. 81.]

The only reasonable conclusion we can reach is that the duties of his position were primarily the investigation of persons suspected of criminal tax fraud which entitled him to consideration for retirement under Section 1(d).

Jurisdiction.

Appellant has cited a number of cases which indicate that if this action were in the nature of a writ of mandamus it would have to be brought in the District of Columbia Circuit, since the Secretary of the Treasury and the members of the Civil Service Commission are officials domiciled in the District of Columbia. It is conceded that the United States District Court for the Southern District of California does not have jurisdiction over such administrative officials. This does not mean, however, that officials of these two Departments can erect an iron wall around their determinations which preclude judicial review. Mandamus is not an exclusive remedy.

The question of jurisdiction under the Tucker Act was settled beyond dispute by this Court in *Anderson v. United States*, 205 F. 2d 326. The *Anderson* case cited *Dismuke v. United States*, 297 U. S. 167, in which the Supreme Court ruled squarely that the United States Dis-

strict Court has jurisdiction in this type of case. The Supreme Court there said:

“We conclude that annuities payable under the Retirement Act are not pensions within the meaning of the Tucker Act and that suits against the Government to recover them are within the jurisdiction of the district courts, is not precluded, as the court below held they are, by the administrative provisions of the language, resort to the courts to assert a right which the statute creates will be deemed to be curtailed only so far as authority to decide is given to the administrative officer. If he is authorized to determine questions of fact his decision must be accepted unless he exceeds his authority by making a determination which is arbitrary or capricious or unsupported by evidence. *Siberschein v. United States*, 266 U. S. 221; *United States v. Williams*, 278 U. S. 255, or by failing to follow a procedure which satisfied elementary standards of fairness and reasonableness essential to the due conduct of the proceedings which Congress has authorized, *Lloyd Sabaudo Societa Anomina v. Elting*, 287 U. S. 329, but the power of the administrative officer will not in the absence of plain command, be deemed to extend to the denial of a right which the statute creates, and to which the claimant, upon facts found or admitted by the administrative officer, is entitled, *United States v. Laughlin*, 249 U. S. 440; *United States v. Hooslep*, 237 U. S. 1; *McLean v. United States*, 226 U. S. 378. The Commissioner is required by Section 13 ‘upon receipt of satisfactory evidence of the character specified “to adjudicate the claim.”’ This does not authorize denial of a claim if the undisputed facts establish its validity as a matter of law, or preclude the courts from ascertaining whether the conceded facts do so establish it.”

This Court noted in the *Anderson* case that the Supreme Court in the *Dismuke* case referred to the claimant's rights as a "statutory right" and a "statutory benefit." In ruling for the annuitant-claimant, the Court further said:

"The rule stated assumes that the right exists if, at all, prior to and independently of any administrative action upon it."

The Failure to Act on Appellee's Request for Retirement Was Based Upon an Error of Law—Not an Error of Fact.

The Supreme Court in the *Dismuke* case had a problem similar to the one at bar. There the question arose as to whether the plaintiff was or was not an employee of the United States. The Court said:

"The administrative decision thus turned upon a question of law, whether a field deputy marshal during the period from December 16, 1895, to December 30, 1902, was an employee of the United States. The Administrative determination of that question is open to review in the present suit, and should have been considered and decided by the Court below."
(297 U. S. 172, 173.)

If such a determination raises a question of law, certainly the right of the Secretary of the Treasury to use a classification which automatically prohibits an applicant's retirement raises a question of law.

As previously pointed out whatever rights Appellee had existed prior to the determination made by the Treasury and Civil Service officials. As this Court said in the *Anderson* case:

"Inaction or denial of the claim by the Commission could not delay or defeat the right, and favorable

adjudication, evidenced by issuance of an annuity certificate, could only formally acknowledge a right already established."

In the *Anderson* case a widow's estate was refused an annuity payment because the widow died before the administrative officials had gotten around to the issuance of a check. On the question of the time at which the widow's rights became fixed this Court said:

"The Court below was of the view that the annuitant can have no right to the annuity until the claim is *adjudicated* by the Commission and a certificate issued. We do not agree. When the annuitant has filed a proper application he has done all that he is required to do. The right must accrue at that time. Cf. *Ewing v. Gardner*, 6 Cir., 185 F. 2d 781, affirming D. C. 88 F. Supp. 315, modified without discussion of this point, 341 U. S. 321, 81 S. Ct. 684, 95 L. Ed. 968. The same Court which rendered the Opinion in *Adams v. Ernst*, *supra*, on which the Court below and Appellee relied, has held that the right to a statutory gratuity vests at the time satisfactory application is made therefor. *Conant v. State*, 197 Washington 21, 84 P. 2d 378; see also *Finley v. Marion Co.*, 81 Or. 294, 159 P. 557.

If there be doubt as to this construction of the Act, we might consider where the construction urged by Appellee would lead us. Taking the view that the right of an annuitant is conditional upon the Commissioner's *adjudication* of his claim, what would be the effect of a wrongful denial of that claim by the Commission? The answer must be that the annuitant could have no right to the annuity in such event, for the condition would hardly be satisfied by an adjudication that the claim is invalid. And to ac-

cept this argument we must be prepared to say that on claims made under the Act the decision of the Commission is final; for if no right can be asserted by an annuitant after an adverse decision by the Commission, it is the Commission which has the first and last say.

The argument cannot be maintained. On the assumed facts there is no doubt that had Mrs. Anderson lived, and had the Civil Service Commission denied her claim, she could have successfully prosecuted an action for the annuity in the Courts."

This Court had no difficulty in deciding that the administrative determination in the *Anderson* case was based on an error of law which gave the District Court jurisdiction. And so it is here. The administrative officials misinterpreted the provisions of Section 1(d) and used a classification instead of individual consideration of eligibility in rejecting Appellee's application for retirement.

Summary of Judgment.

Appellee, who at the time of application for retirement was over 50 years of age, had rendered more than 20 years of service in a position whose duties were primarily the investigation of persons suspected of offenses against the criminal laws of the United States. Furthermore, he was subjected to a degree of hazard in the performance of his duties contemplated by Section 1(d) and should have been retired under that section upon his request. The refusal of the Secretary of the Treasury and the Civil Service Commission to grant such requirement was based solely upon the reason that Appellee was not in a class of position listed under the heading "Internal Revenue Service positions covered by Section 1(d)

Retirement Act.” No consideration was given to Appellee’s personal qualifications for retirement under Section 1(d) nor did the officials consider the degree of hazard to which Appellee had been subjected. On the contrary, these officials based the refusal for retirement on “the general duties of the class of the position” held by Appellee, contrary to the provisions of Section 1(d). The refusal of the Secretary of the Treasury and the Civil Service Commission to retire Appellee was based upon an erroneous interpretation of the statute. It is therefore submitted that the trial court correctly decided that Appellee was entitled to a money judgment in the sum of \$760.00.

Conclusion.

For the foregoing reasons, it is respectfully submitted that the judgment below should be affirmed.

Respectfully submitted,

ERNEST R. MORTENSON,

Attorney for Appellee.

EXTRACT
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No. 16007 ✓

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MONROE B. HARRIS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF.

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United States Attorney,

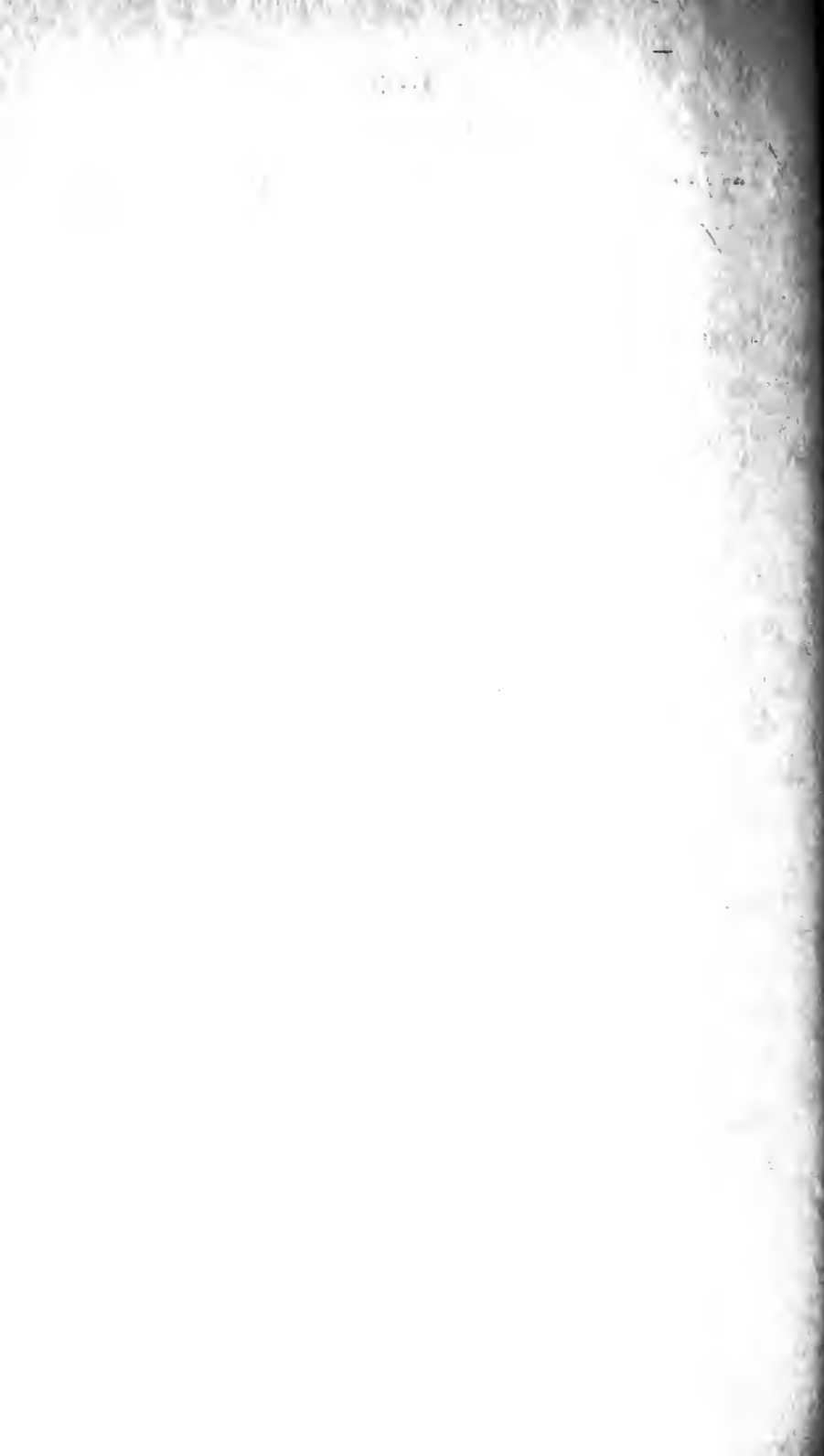
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TOPICAL INDEX

	PAGE
Statement of jurisdiction.....	1
Statement of the case.....	2
Argument.....	6

I.

The evidence was sufficient to support the verdict of guilty....	6
--	---

II.

No hearsay evidence was admitted against the appellant.....	10
---	----

III.

No forced confession or violation of due process arose by reason of the brutality accorded the witness Marvin Wil- liams	11
--	----

IV.

The prosecuting attorney committed no misconduct.....	13
---	----

V.

The trial court properly instructed the jury.....	20
Conclusion	22

TABLE OF AUTHORITIES CITED

CASES	PAGE
Alberty v. United States, 91 F. 2d 461.....	18
Booth v. United States, 154 F. 2d 73.....	7
Cawley v. State, 248 P. 2d 273.....	12
Delli Paoli v. United States, 352 U. S. 232.....	10
Diggs v. United States, 220 Fed. 545, aff'd 242 U. S. 470.....	21
Doherty v. United States, 230 F. 2d 605.....	20
Edwards v. United States, 139 F. 2d 365.....	8
Henderson v. United States, 218 F. 2d 14.....	14, 18
McNamara v. Henkel, 266 U. S. 520.....	8
Morandy v. United States, 170 F. 2d 5.....	7
Pina v. United States, 165 F. 2d 890.....	21
Powell v. United States, 35 F. 2d 941.....	19
Risinger v. United States, 236 F. 2d 96.....	21
Rochin v. California, 342 U. S. 165.....	11
Schmidt v. United States, 237 F. 2d 542.....	14
Stevenson v. United States, 211 F. 2d 702.....	21
Stewart v. United States, 247 F. 2d 42.....	15, 18

STATUTES

United States Code, Title 18, Sec. 2115.....	2
United States Code, Title 18, Sec. 3231.....	2
United States Code, Title 28, Sec. 1291.....	2

No. 16007
IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MONROE B. HARRIS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF.

Statement of Jurisdiction.

Appellant was indicted by the Grand Jury for the Southern District of California on August 1, 1956, on a charge of breaking into a building used as a post office [Clk. T. 2].¹

On August 6, 1956, the defendant was arraigned and on August 13, 1956, the defendant entered a plea of not guilty to the charge in the indictment [Clk. T. 5, 6]. On September 11, 1956, jury trial began in the United States District Court for the Southern District of California, the Honorable Ben Harrison presiding [Clk. T. 8]. On September 12, 1956, the case was concluded by a verdict of guilty as to the appellant on the charge in the indictment [Clk. T. 15].

On October 1, 1956, it was adjudged that appellant be committed to the custody of the Attorney General for a period of five years [Clk. T. 3].

¹Clk. T. refers to the Clerk's Transcript of Record.

On October 3, 1956, a timely notice of appeal was filed [Clk. T. 17].

The District Court had jurisdiction of this action under United States Code, Title 18, Sections 2115 and 3231.

This Court has jurisdiction under the provisions of United States Code, Title 28, Section 1291.

Statement of the Case.

In the early morning hours of July 8, 1956, at approximately 1 a. m., one Robert E. Lee, who lived opposite the back of the instant United States Post Office, heard a noise, and, upon looking out of his rear window, saw men in the alley behind the Post Office and heard their voices [R. T. 17-18, 20].² In addition, Mr. Lee also observed a truck with the red letters "CENTRAL" on top thereof [R. T. 18].

At approximately 2 a. m. on July 8, 1956, Mr. Lee again heard a noise from the rear of the Post Office and called the police [R. T. 19]. He saw an object on the ground in the alley behind the Post Office, and when he later went to the rear of the Post Office after police officers had arrived, he observed a large safe lying on the ground in the same position in which he had previously observed the object from his window [R. T. 20].

Later examination of the Post Office revealed that there was a hole in the roof caused by several boards which had been pulled up from the roof [R. T. 41-43]. Moreover, two safes, one large and one small, had been removed from the premises of the Post Office and the petty cash drawer of the Post Office had been pried open and ninety-five cents in change was missing [R. T. 39-41]. The

²R. T. will refer to the Reporter's Transcript.

Superintendent of the Post Office, Wilbur N. Ashford, also testified that the rear platform doors of the Post Office were open as well as the door to the Inspector's lookout, which opened off the back platform [R. T. 39]. The large safe which was missing from the inside of the Post Office was found by Mr. Ashford to be lying on its side in the loading dock area just off the platform at the rear of the Post Office [R. T. 39].

The codefendant, Thomas B. Venters (whose case of receiving stolen property was consolidated with the instant case) was arrested at 2:20 a. m. on the morning of July 8, 1956 [R. T. 60, 62] by Deputy Sheriff Donald E. Zimmerman who first observed two men standing at the corner of the alley behind the Post Office and then later arrested Venters and others in an automobile parked approximately a block away towards which the two men had run [R. T. 95, 97].

The appellant was arrested by Los Angeles Police Officer Elmer N. Owens approximately one and one-half blocks from the burglarized Post Office at approximately 3 a. m. on the morning of July 8, 1956 [R. T. 45-46, 57]. For approximately 25 minutes before he observed the appellant that night, Officer Owens had been staked out upon a truck bearing the red letters "CENTRAL" [R. T. 46-47, 52]. Owens saw Harris approach on foot, get into the truck and drive the truck away for approximately a block and a half, at which time the appellant was placed under arrest [R. T. 45, 47-48]. The rear of the truck platform was observed to be damaged [R. T. 49].

Upon searching Harris, Owens observed that dirt was matted in his hair, his hands were scraped and bleeding and there was blood upon the appellant's shirt [R. T. 49]. At the time of arrest, appellant told Owens that he did

not know anything about the truck [R. T. 51], and that he had obtained three rides that evening by hitch-hiking. The appellant further stated that the last person who had given him a ride, a man in a green 1956 Chevrolet automobile, had asked him if he would like to make three or four dollars by driving a truck, to which appellant assented since he did not have any funds on him [R. T. 51-52]. Appellant stated that he was driven to the location of the truck by the man in the 1956 green Chevrolet sedan [R. T. 52].

In contrast to the story told by appellant, Officer Owens testified that no automobile drove the appellant to where the truck was parked [R. T. 52]. Approximately \$3.40 was found in Harris' possession at the time he was arrested [R. T. 53]. Later in the evening, appellant was asked by Officer Owens if he knew a man by the name of Marvin Williams and Harris replied that he did not [R. T. 52]. In appellant's possession at the time of his arrest was a notebook containing the name, address and phone number of Marvin Williams [R. T. 53].

The codefendant Thomas B. Venters testified that Harris came to his house on the morning of July 7, 1956, and asked if he could rent a garage for a friend by the name of Williams [R. T. 146-148, 166]. It was in Venters' garage that the second small safe, which had been taken from the burglarized Post Office, was found [R. T. 95, 97].

Marvin Williams testified that on July 8, 1956, between 1:30 and 2 a. m. the appellant came to his home and asked

him to help him, the appellant, move something [R. T. 100-101]. Williams then went to an automobile with the appellant and drove, together with codefendant Venters, to the vicinity of the Post Office [*ibid*]. There Williams observed a large safe lying on its side on the ground behind the Post Office and appellant then stated to the persons gathered there "Let's see if we can lift this" [R. T. 102-103].

Williams also testified that he was arrested on July 8, 1956, and was thereafter beaten by officers at the 77th Street Station of the Los Angeles Police Department [R. T. 120-121]. Postal Inspectors had nothing to do with the arrest or beating of the witness Williams [R. T. 119]. The District Judge extensively questioned the witness concerning whether he was telling the truth at the time of trial and Williams stated that the testimony which he was giving at the trial was the truth, stating that when he was first arrested he told the officers a lie to the effect that he had been in the vicinity of the Post Office to get a drink and that he did not know anything else about the Post Office [R. T. 125]. Williams testified that he later told the officers that his previous statements were a lie and that he then told them the truth and that he was telling the truth on the stand [R. T. 125-126].

ARGUMENT.

I.

The Evidence Was Sufficient to Support the Verdict of Guilty.

At pages 7 through 10 of his brief, appellant cites various California cases supporting general propositions of law to the effect that the instant evidence was insufficient to uphold the conviction. Other comments upon the evidence are made by the appellant at pages 1 through 5 of his brief.

We believe that the evidence set forth in the appellee's statement of facts is more than sufficient to uphold the verdict of guilty. Appellant was in possession of a stolen safe in early morning hours in the back of a just-burglarized Post Office [R. T. 102-103]. Appellant moreover attempted to lift the safe and went to the trouble of obtaining assistance from his school friend, Marvin Williams [R. T. 100-101, 122].

Next, appellant was arrested at 3 a. m. in the vicinity of the Post Office [R. T. 48, 57]. The appearance of the appellant could lead the jury to believe that it was he who had gained access to the roof of the Post Office, in view of his bloody and scraped condition [R. T. 48-49].

Moreover, appellant told the arresting officer several untruths at the time of his arrest. The first untruth was that a man in a green Chevrolet had driven him to the vicinity of the truck with the red letters "CENTRAL" upon it. The second was that he had no funds that evening. The third untruth was that he did not know a man by the name of Marvin Williams. The story told the officer was entirely inconsistent with that of the witness Elijah Washington, the only witness testifying on behalf of the appellant. Washington testified that he had met the ap-

pellant in the early morning hours of July 8, 1956, and had driven him to the vicinity of Vernon and Central [R. T. 177-178], whereas the appellant had told the officer that he had hitched a ride from three separate unknown individuals [R. T. 51].

Also, appellant was in possession of the truck which obviously had been used to transport the small safe to the garage of codefendant Venters [R. T. 18].

In addition, the garage in which one of the stolen safes was found had been (according to the codefendant Venters) rented by the appellant in the morning of July 7, 1956 [R. T. 146-148, 166].

Without reviewing the California cases cited by the appellant at pages 8-9 of his brief to the effect that unexplained possession of stolen property is not by itself sufficient to justify conviction of burglary, it is sufficient to say that the rule is to the contrary in federal courts. In *Booth v. United States*, 154 F. 2d 73 (C. A. 9, 1946), it was stated by this Court:

“From the possession of the stolen securities there arises not only an inference which the jury *may* draw, but a presumption which *must* be recognized by the jury that the possessor is the thief . . . it is a part of the common experience of man that the possessor of goods soon after a theft is the thief.”

In *Morandy v. United States*, 170 F. 2d 5 (C. A. 9, 1948), it was stated by this Court:

“As seen, [the car] had recently been stolen in Indiana; and appellant did not take the stand or in any way attempt to explain his possession of it in California. The courts have long thought that possession in such circumstances warrants the inference that the possessor was the thief. This judicially

sanctioned inference, we may add, has its genesis in human experience, that is to say, it is not a rule conveniently concocted by judges to fill gaps in the proof."

In *Edwards v. United States*, 139 F. 2d 365 (C. A. D. C., 1944), the only evidence against the appellant therein was that the crimes of burglary and larceny had been committed in a store and that a week after the crime was committed the appellant was arrested with the codefendant (who had been identified as being the robber) and the appellant was in possession of a part of the stolen property. No evidence was offered to explain the appellant's possession of the stolen property or his association with Anderson. The Court went on to say that:

"This Court has held that possession of recently stolen property, unexplained, is sufficient to support a verdict of guilty in larceny. Housebreaking, robbery and burglary are merely aggravated forms of larceny and there is no reason why evidence competent in one case should not be competent, also, in the others. In fact, the Supreme Court has extended the rule so far as to declare that possession of the fruits of crime, recently after its commission, may be of controlling weight in a *murder* case, unless explained by the circumstances or accounted for in some way consistent with innocence."

The judgment of the trial court was affirmed.

In the case of *McNamara v. Henkel*, 266 U. S. 520 (1913), the question before the Supreme Court was whether there had been any competent evidence to connect the appellant with the crime of burglary. A building had been broken into which was used as a garage and stolen therefrom was an automobile and some rugs. It was shown that the automobile had been taken out of the building and rolled about forty feet down the street where,

according to the testimony, the appellant was seen standing in front of the car "trying to crank it." Three unidentified men also were with him. The Supreme Court held:

"The District Court held that this was evidence connecting the appellant with the crime. . . . We agree with this view. . . . It is objected that while possession of property recently stolen may be evidence of participation in the larceny, the apparent possession of the automobile by the appellant affords no support for a conclusion that he committed the burglary, the crime with which he was charged. The permissible inference is not thus to be limited. The evidence pointed to the appellant as one having control of the car and engaged in the endeavor to secure the fruits of the burglarious entry. Possession in these circumstances tended to show guilty participation in the burglary. This is but to accord to the evidence, if unexplained, its natural probative force."

In the instant case, appellant was standing next to a large safe stolen from an immediately adjacent Post Office and was attempting to lift such safe. He was also arrested in a truck which had been used in the commission of the burglary and larceny of the safes. According to one of the codefendants he also was responsible for rental of the garage in which one of the other stolen safes was later found. In view of the foregoing cases, we believe that the evidence in the Court below was more than sufficient to justify the judgment of the trial court.

II.

No Hearsay Evidence Was Admitted Against the Appellant.

At pages 5 and 10 of the appellant's brief, it is argued that hearsay statements were introduced at the time of trial. Whether these statements were competent and admissible evidence as to the codefendant Venters is not a question which this Court is called upon to answer. The question is whether such evidence prejudiced the appellant.

At the times that the objected-to evidence was introduced against the codefendant Venters, it always was specifically made clear by the prosecution that such evidence was offered solely as to Venters and not as to the appellant [R. T. 76, 77, 78, 82, 94]. The trial court also painstakingly made clear to the jury that it should disregard such evidence insofar as the appellant Harris was concerned [R. T. 76, 94, 169, 181-182, 185, 224-225]. In view of the foregoing, we deem it inconceivable that the jury could have misunderstood and considered such evidence in determining the case of the appellant. To believe otherwise, would be to disregard our system of expecting juries to follow the Court's instructions of law.

Delli Paoli v. United States, 352 U. S. 232, 236-243 (1957).

III.

**No Forced Confession or Violation of Due Process
Arose by Reason of the Brutality Accorded the
Witness Marvin Williams.**

We deplore the brutality accorded to the witness Marvin F. Williams. We trust that this statement alone will make clear our position upon that point. This does not mean, however, that we believe we should not have used the testimony of the witness, or that the witness' testimony was thereby incompetent to be received in evidence or that the entire case should have been dismissed for lack of due process.

If such brutality had been inflicted or caused by federal officers a serious question as to the means by which the conviction was secured might have arisen. See *Rochin v. California*, 342 U. S. 165. However, the arrest of Williams, as well as the arrest of the other defendants in this case, was at the hands of local officers and the United States had no control over this case until the release by the local authorities of the defendants to the United States. Since the federal Government had nothing to do with the instant brutality, we do not see why the United States should be deprived of such a percipient witness to the crime.

The fact that Mr. Williams told what he classed to be a lie to the police officers [R. T. 125], was beaten and then told the officers what he also stated to the trial court to be the truth, should merely go to the credibility of the evidence offered rather than to the competency or admissibil-

ity of such testimony. In *Cawley v. State*, 248 P. 2d 273 (Okla., 1952), illegal means had been used to obtain the testimony of a witness by the name of Weekly. The defendant therein contended that he had thereby been convicted without due process of law. The Court stated:

“The foregoing methods may have prompted the testimony of Clarence Bo Weekly, and they may have been the means of obtaining the truth. Certainly the county attorney and the sheriff were acting beyond the law in holding Weekly in jail on the two occasions in question without process so to do. When officers so act they no longer are instruments of lawful administration of justice but become a law unto themselves. Of course the remedy for recompense for unlawful arrest and imprisonment is with Weekly, not this defendant. Furthermore, *the facts as hereinbefore related did not go to the competency of his evidence, but only as to its credibility. If duress or coercion was used to obtain the testimony of a witness, this fact goes to the credibility of the witness.* 70 C. J. 769, §934, Note 68 [98 C. J. S. 331, Witnesses §463] . . . the evidence thus obtained in the case at bar was entitled to the smallest weight but it was the jury’s province to believe it if they so desired.”

Thus, we believe no error was committed by the trial court below in receiving the evidence of the witness Williams.

IV.

The Prosecuting Attorney Committed No Misconduct.

Misconduct of the government's trial attorney is alleged in two respects. First, it is stated that the following remarks addressed to the Court immediately preceding the Court's acquittal of one of the codefendants were prejudicial:

"Mr. Bevan: Your Honor, this is the government's last witness; but before I rest, I would like to make a statement to you.

Whether or not I might think the defendant Jack is guilty of this offense, I do not consider there to be sufficient evidence to present the case to the jury. By our Rules we may dismiss a case on our own motion only by authority of the Department of Justice in Washington, so I don't have authority to do that. I do want to tell you that, in my mind, I, and I think any other Federal prosecutor, could not conscientiously give a case to the jury, whether or not they believe the man guilty, where there is such slight evidence of his guilt." [R. T. 185-186.]

At pages 5-6, and 12-13 of the Appellant's Brief, it is argued that such remarks of the prosecutor "implied great fairness on the part of the government and further implied overwhelming evidence of appellant's guilt as the only reason that prosecution against the latter was not dropped." No cases are cited as authority for the proposition that such remarks were prejudicial. We are frank to say that we do not see how implied fairness on the part of the government could prejudice this or any other criminal defendant. Further, we do not believe the re-

marks fairly can be construed to imply that there was overwhelming evidence of appellant's guilt as contrasted with that of the codefendant Jack. Even if they were so construed, it is permissible for a prosecutor to *directly* express *his belief* in the guilt of the defendant, if such belief is based upon the evidence and inferences therefrom, and certainly may state directly that there is overwhelming evidence of a defendant's guilt.

Henderson v. United States, 218 F. 2d 14, 19 (C. A. 6, 1955);

Schmidt v. United States, 237 F. 2d 542 (C. A. 8, 1956).

If it be permissible to directly state such an opinion (which was done by the prosecutor at page 193 of the Reporter's Transcript) then we see no misconduct arising from an implied such statement. In any event, immediately following the alleged prejudicial remarks of the prosecutor, the trial court stated:

"I want to instruct the jury . . . that it is the position of the Court that no one should be convicted on suspicion. And because I am dismissing as to defendant Jack, it is not to be considered that the Court, in any way, intimates or suggests that the Court believes or *anybody else believes* connected with the case that the other two defendants are guilty or not guilty. That is a matter that is entirely your problem. . . . So, because I have dismissed this as to one defendant, I don't want to intimate in any way, shape, or form that I believe that the other two defendants are guilty. That is a question that is entirely your problem." [R. T. 186-187.]

If the above quoted remark of the prosecutor be considered to be error, it was immediately cured by the statements of the trial court.

The next act of misconduct which is attributed to the government trial attorney was that in argument, he implied "that the jury was a part and parcel of . . . the 'administration of justice'" (App. Br. p. 6). It is thus argued (App. Br. p. 13) that the prosecutor identified the jury with law enforcement rather than with their position as impartial judges, "thus adding further prejudice to the rights of appellant." The alleged misconduct in this respect consists of the following argument by the prosecutor:

"Nevertheless, you will have occasion to go in and do your duty; *that is, to judge the evidence here*; and to do your duty just as Mr. Lee did when he saw these men out there and phoned the police. He did everything that he could. The police officers arrived immediately. You have seen a fine example of how police work can happen. They did everything that they could to bring in a proper case here to you. The inspectors have done their jobs. I have tried to do what little I had to do here, to present the evidence to you. And this final link, and more important one, in the chain of administration of justice is up to each of you ladies. Each of you is going to be called upon to do her duty this afternoon, or perhaps tomorrow. And I hope that when you go home and your verdict has finally been reached, you will be proud of yourselves and proud of the manner in which you reached your verdict and in the verdict that you yourselves have rendered."

In *Stewart v. United States*, 247 F. 2d 42 (C. A. D. C. 1957), an exhaustive and excellent review of federal cases

involving alleged misconduct of prosecutors is made by the dissenting judge, with whom three other Circuit Judges joined in the dissent. It is stated therein at page 51:

“The cases disclose that alleged misconduct of a prosecutor in his argument to a jury is generally founded on a claim that he departed from his role as advocate by testifying as a witness not under oath and not subject to cross examination, or that his argument was so grossly, excessively inflammatory and his vilification of the defendant and his witnesses so extreme as to induce the jury to forsake the record and decide the issues on the basis of passion and prejudice [cases cited].”

* * * * *

“For alleged misconduct because of abusive, inflammatory language to be error it must be shown to have been more than an isolated indulgence in the lurid or just any invocation of passion. To amount to legal error such conduct must be repeated, extreme, reckless and without regard for a trial based upon the evidence [cases cited].”

* * * * *

“There are numerous decisions which take the position that error arising from improper argument can be cured by countervailing comment, by admonishing the jury to disregard the improper argument and not to treat it as evidence, or by instruction to the jury as to the function and purpose of argument [cases cited].”

* * * * *

“Furthermore, we are impressed by the fact that appellant’s experienced counsel could have interposed some objection if, under the circumstances of the trial referred to above, the government attorney’s remarks were prejudicial to his client. That one chiefly responsible for the protection of the accused did not object is persuasive that the alleged misconduct was not prejudicial [cases cited]. Defense counsel was present; he heard the statements this Court has questioned; he was aware of the emotional and psychological atmosphere prevailing at the trial; he, and not this Court, was the principal reliance of his client in protecting appellant’s legal rights. He did not object. Can this Court, which has before it only paper and ink, determine better than he whether the prosecutor’s remarks prejudiced appellant’s case? We think not.

“Research indicates that, in order to be available as a basis for reversal on appeal, alleged improper argument should be objected to at trial [cases cited].

“The basis for this Rule is that a party should not be permitted to gamble on the possibility of a favorable verdict and then, when a verdict of guilty is returned, attack it because of alleged errors which could have been obviated had he interposed a timely objection [cases cited].”

* * * * *

“To reverse this conviction implies that the attorney who afforded appellant a diligent and aggressive defense has standards of professional conduct so gross that he could not recognize improper and pre-

judicial conduct on the part of his adversary. It implies that defense counsel was less interested in providing adequate defense of his client and securing a fair trial than this court. Reversal on these grounds by this court would also imply that trial judges in this jurisdiction are either unaware of what constitutes a fair trial or less interested in insuring it than this court.”

Very little can be added to the learned discussion that is set forth in the dissenting opinion in *Stewart v. United States*, *supra*. However, it always has been a well established rule that

“In the closing argument to a jury, the government attorney is an advocate, as is counsel for defense, and proper oratorical emphasis is denied to neither [cases cited].”

Henderson v. United States, 218 F. 2d 14, 19 (C. A 6, 1955), *supra*.

Also, it has long been the rule of this Court that there must have been an objection at the trial below to the alleged misconduct of the prosecutor to take advantage of the error on appeal. In *Alberty v. United States*, 91 F. 2d 461 (C. A. 9, 1937), the assignments of error raised questions as to the propriety of government counsel’s conduct. This Court stated at page 463:

“Whatever hesitation counsel may have regarding a claim of misconduct of a trial judge, there should be none in claiming it against the prosecutor. It should be made at once. The Court should be given the opportunity for instant correction and, if the of-

fense be sufficiently hurtful, declare a mistrial. Counsel cannot occupy the instruments of justice, the Court and jury, in an extended trial and, without objection or motion for relief, raise such questions on appeal.”

It was stated in *Powell v. United States*, 35 F. 2d 941, 943 (C. A. 9, 1929):

“It is next assigned as error that the Court should have instructed the jury to disregard a statement or offer made by the United States Attorney during the trial; *but it is sufficient to say that there was no request for any such instruction.*”

In summary, we do not believe that this Court should find that the prosecutor’s remarks were in any sense “inflammatory” and thus error. In any event, no objection was made to either the argument of the prosecutor or his statement made immediately preceding the dismissal of the case against codefendant Jack. Moreover, at page 12 of the Reporter’s Transcript, the prosecutor stated:

“In my argument to you at the conclusion of the trial, and any statements I might make throughout the course of the trial are not to be considered by you as evidence. . . .”

Furthermore, the trial court stated, at page 222 of the Reporter’s Transcript, to the jury:

“You must weigh and consider this case without regard to sympathy, prejudice, or passion for or against any party to the action.”

Thus, whatever conceivable prejudice might have been created by the alleged misconduct of the prosecutor, it would seem to have been cured by his own opening remarks to the jury and by the Court’s final instructions.

V.

The Trial Court Properly Instructed the Jury.

It is alleged by appellant, upon the basis of various California decisions, that the experienced trial judge, Ben Harrison, did not properly instruct the jury as to certain elementary principles of federal law. First of all, appellant complains that the District Judge's instruction as to reasonable doubt "would seem to place less than the well-established burden upon the prosecution" (App. Br. pp. 6-7). We believe that we need only refer to pages 214-215, 217, 220 of the Reporter's Transcript wherein the Court gave its instructions as to burden of proof, presumption of innocence and reasonable doubt, and certain other matters, to advance sufficient argument in support of the Court's instructions.

At pages 18-19 of Appellant's Brief, it is also stated that there was omitted an instruction as to the testimony of an accomplice, the appellant citing a form California jury instruction, and thus it is alleged that error was committed thereby. In many respects, including this one, California and federal law are entirely different. As held by this Court in *Doherty v. United States*, 230 F. 2d 605 (C. A. 9, 1956):

"This appeal from a judgment of conviction . . . is predicated upon the assumption that the California rule declining to credit testimony of an accomplice, unless corroborated, is applicable in the Federal Courts."

* * * * *

"It is settled in this Circuit that, while received with caution and weighed with great care, the uncorroborated testimony of an accomplice is to be accorded whatever credibility the trier of facts may think it deserves."

Moreover, it is not error for a court to *refuse* to give an instruction regarding the credibility of an accomplice, and it is to be noted that in the instant case no request for an accomplice instruction was made.

Pina v. United States, 165 F. 2d 890 (C. A. 9, 1948), held:

“This Court has held that refusal to give an instruction regarding the credibility of an accomplice is not reversible error.”

See also:

Diggs v. United States, 220 Fed. 545 (C. A. 9, 1915), affirmed 242 U. S. 470, 495.

Furthermore, as we interpret the evidence, no accomplice witness was used by the prosecution. The usual test of determining an accomplice was defined in *Stevenson v. United States*, 211 F. 2d 702 (C. A. 9, 1954), as being whether the supposed accomplice

“could be convicted of the identical crime for which the defendant is being prosecuted.”

See also:

Risinger v. United States, 236 F. 2d 96, 99 (C. A. 5, 1956).

Although the appellant has not designated the person alleged to be an accomplice, we presume that he means Marvin Williams. According to the evidence introduced at this trial, we deem it inconceivable that Marvin Williams could have been convicted of the crime for which the appellant was prosecuted, or indeed, for any crime. Consequently, we believe that no error was committed by the trial court's failure to instruct on the testimony of an accomplice, first, because there was no such accomplice and, second, because such failure is not error according to decisions of this Court.

Conclusion.

There being no error in the trial below, the judgment of the District Court should be affirmed.

Respectfully submitted,

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No. 16008 ✓

United States
Court of Appeals
for the Ninth Circuit

SKOKOMISH INDIAN TRIBE, Appellant,

vs.

E. L. FRANCE, Trustee, et al., Appellees.

Transcript of Record

Appeal from the United States District Court for the
Western District of Washington,
Southern Division

FILED
SEP 3 - 1958
PAUL P. O'BRIEN, CLERK



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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	PAGE
Affidavit of W. L. Brown, Jr. In Support of Motion of City of Tacoma to Dismiss:	
Filed Feb. 19, 1954	59
Filed Feb. 23, 1956	73
Affidavit of Glenn E. Correa in Support of Motion of Charles T. Wright to Dismiss, Filed Feb. 10, 1954	54
Amended Motion to Dismiss of Charles T. Wright, Filed Feb. 21, 1949	35
Appeal:	
Bond for Costs on	135
Certificates of Clerk to Transcript of Record on	142, 145
Designation of Appellees of Record on (USCA)	151
Motion for Order Directing Transmittal of Original Records on	139
Motion to Extend Time to File Record and Docket	136
Notice of	134

ii.

Appeal—(Continued):

Order Directing Transmittal of Original Records on	141
Order Extending Time for Filing Record and Docketing	138
Statement of Points and Designation of Record on, Appellant's (USCA)	148
Bond for Costs on Appeal Filed Jan. 6, 1958 ..	135
Certificates of Clerk to Transcript of Rec- ord	142, 145
Complaint, Filed Dec. 3, 1948	3
Decision of June 12, 1957, Filed July 25, 1957	117
Decision of August 2, 1957, Filed Oct. 2, 1957 ..	129
Designation of Record to be Printed, Appel- lant's (USCA)	149
Designation of Record, Appellees' (USCA) ..	151
Letter from City Attorney, Tacoma, to Clerk, U. S. District Court re Call Calendar, etc. Dated Oct. 5, 1955	71
Memorandum Brief in Favor of State of Wash- ington's Motion to Dismiss, Filed Apr. 27, 1951	42
Memorandum of U. S. Attorney, Filed Aug. 1, 1957	126
Memorandum Opinion and Order Denying Motions to Dismiss Complaint, Filed July 29, 1952	47

iii.

Motion for Order Directing Transmittal of Original Records to Court of Appeals, Filed Apr. 30, 1958	139
Motion of Plaintiff for Order to Join United States as Added Party Plaintiff, Filed July 31, 1957	125
Motion to Dismiss Action, Filed:	
Feb. 21, 1949, Chas. T. Wright	35
May 23, 1949, Chapmans	37
Aug. 17, 1949, Nalleys	39
Dec. 28, 1949, Worl, et al	40
Apr. 27, 1951, State of Washington	42
June 4, 1951, Simpson Logging Co., et al ..	45
Feb. 10, 1954, Hunters	53
Feb. 10, 1954, Wright	54
Feb. 19, 1954, France, Trustee, et al	57
Feb. 19, 1954, Hanson, et al	57
Feb. 19, 1954, City of Tacoma	58
Feb. 20, 1954, State of Washington	60
Feb. 23, 1954, Carlson, et al	61
July 23, 1956, City of Tacoma	72
Motion to Extend Time to File Record and Docket Cause, Filed Feb. 3, 1958	136
Names and Addresses of Attorneys	1
Notice of Appeal, Filed Jan. 6, 1958	134
Notice of Appearance of State of Washington, Filed July 14, 1949	38

Order Denying Motions to Dismiss for Want of Prosecution and Setting for Trial and Pretrial Conference, Filed Apr. 20, 1954 ..	61
Order Directing Transmittal of Original Rec- ord to Court of Appeals, Filed Apr. 30, 1958	141
Order Dismissing the United States as a Party Defendant, Filed Mar. 17, 1949	36
Order Extending Time for Docketing Appeal and Filing Record, Filed Feb. 3, 1958 ...	138
Order of Dismissal, Filed Dec. 9, 1957	132
Pretrial Order, Filed Oct. 1, 1956 (Partial) ..	80
Reasons and Authorities in Support of Motion of All Defendants Except State of Wash- ington to Dismiss, Filed July 23, 1956 ..	75
Statement of Points and Designation of Rec- ord, Appellant's (USCA)	148
Statement of State of Washington as to Its Position on Jurisdiction, Filed Mar. 16, 1955	64
Stipulation re Dismissal of United States, Filed Feb. 18, 1949	33
Transcript of Court's Oral Decision, June 12, 1957, Filed July 25, 1957	117
Transcript of Court's Oral Decision Rendered Aug. 2, 1957, Filed Oct. 2, 1957	129

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District Court of the United States, Western
District of Washington, Southern Division

No. 1183

THE SKOKOMISH INDIAN TRIBE,

Plaintiff,

vs.

E. L. FRANCE, Trustee, CARRIE H. KLEIN, a widow, CLARA B. VANCE, ESTATE OF E. S. AVEY, MINNIE E. WATSON, W. H. FRANCE, JANE DOE FRANCE, E. L. FRANCE and LEO B. FRANCE, husband and wife, ERNEST CARLSON and HULDA S. CARLSON, husband and wife, GEORGE F. WOLF and VIVIAN A. WOLF, husband and wife, POTLATCH COMMERCIAL AND TERMINAL COMPANY, a corporation, RALPH E. ALEXANDER and ADELINE T. ALEXANDER, husband and wife, ROBERT T. SHELDON and LILLIAN C. SHELDON, husband and wife, ALLEN M. STRINE, DANIEL R. DORAN and FLORENCE DORAN, husband and wife, SIMPSON LOGGING COMPANY, CITY OF TACOMA, a municipal corporation, GEORGE SIMPSON, GEORGE W. WILLIS, and GRACE F. WILLIS, husband and wife, JOHN W. PHILLIPS and JEAN S. PHILLIPS, husband and wife, ERNEST WORL and BEULAH WORL, husband and wife, PHOENIX LOGGING COMPANY, C. H. EVERETT and LILLIAN EVERETT, husband and wife, WALTER ASEN and LORRAINE ASEN, LUELLA L. GREELEY, CARL J. MACKE and FLORENCE MACKE, husband and wife, F. G. CHAPMAN and BERTHA A. CHAPMAN, husband and wife, FRED HANSON, WALLACE O. HANSON, BUSTER F. HANSON, OLYMPIA F. KERN, AGNES GRANGER, ALICE HANSON, THE CASCO COMPANY, a Washington corporation, SEATTLE FIRST NATIONAL BANK, MILLARD LEMON, J. T. THACKER, LOLA F. FALKNOR, A. J. FALKNOR, ANNIE P. THACKER, FRED BARNES, WANDA BARNES, N. WARD, FRANK WARD, SIDNEY WARD, LAWRENCE WARD, STATE OF WASHINGTON, JAMES J. SMITH,

HOMER THACKER, JESSIE M. HOPKINS, MARCUS NALLEY and FRANCES NALLEY, husband and wife, E. A. SIMS, CHARLES T. WRIGHT, PAUL HUNTER and JANE DOE HUNTER, his wife, FRANK A. ROBISON, UNITED STATES OF AMERICA (Bonneville Power Administration),
Defendants.

COMPLAINT

Comes now the Skokomish Indian Tribe, a tribe of Indians incorporated under the Act of Congress, June 18, 1934 (48 Stat. 984) as amended by the Act of June 15, 1935, (49 Stat. 378) and brings this complaint by and through its attorneys, and alleges:

I.

That the Skokomish Indian Tribe is a tribe of Indians incorporated under the Acts of Congress herein set out, living near or adjacent to the Skokomish Indian Reservation in the state of Washington, and acting pursuant to its corporate charter and constitution and bylaws has by resolution of its Tribal Council authorized its attorneys herein to bring the within action.

II.

That the jurisdiction of this Court arises in this matter for the reason that plaintiff is an Indian Tribe incorporated under the Acts of Congress, and the rights demanded to be protected arise out of an Indian treaty entered into between said Indian Tribe and the United States, and the matter in controversy exceeds, exclusive of interest and costs the sum of Three Thousand Dollars.

III.

That the Skokomish Indian Reservation is situated at the head of Hood's Canal in the state of Washington, and includes tidelands on the Canal within the boundaries of said Skokomish Indian Reservation.

IV.

That by the Treaty of January 26, 1855, entered into between the United States of America and the Skokomish Indian Tribe, together with other tribes, certain lands in the vicinity of Hood's Canal were ceded to the United States (Treaty of January 26, 1855, proclaimed April 29, 1859—12 Stat. 933).

V.

That Article 2 of said Treaty of January 26, 1855, reserved to the tribes executing said treaty, including the Skokomish Indian Tribe, the plaintiff herein, an aggregate of six sections of land at the head of Hood's Canal, in the following language:

“Article 2. There is, however, reserved for the present use and occupation of the said tribes and bands the following tract of land, viz: The amount of six sections, or three thousand eight hundred and forty acres situated at the head of Hood's Canal, to be hereafter set apart, and so far as necessary, surveyed and marked out for their exclusive use; nor shall any white man be permitted to reside upon the same without permission of the said tribes and bands, and of the superintendent or agent; but, if necessary for the public convenience, roads may

be run through the said reservation, the Indians being compensated for any damage thereby done them. It is, however, understood that should the President of the United States hereafter see fit to place upon the said reservation any other friendly tribe or band, to occupy the same in common with those above mentioned, he shall be at liberty to do so."

VI.

That by Executive Order of February 24, 1874, President Grant set aside the present Skokomish Indian Reservation, employing a metes and bounds description, contained in the following Order:

"Executive Mansion,

February 25, 1874.

"It is hereby ordered that there be withdrawn from sale or other disposition and set apart for the use of the S'Klallam Indians the following tract of country on Hood's Canal in Washington Territory, inclusive of the six sections situated at the head of Hood's Canal, reserved by treaty with said Indians January 26, 1855 (Stats. at Large, vol. 12, p. 934), described and bounded as follows: Beginning at the mouth of the Skokomish River; thence up said river to a point intersected by the section line between sections 15 and 16 of township 21 north, in range 4 west; thence north on said line to a corner common to sections 27, 28, 33 and 34 of township 22 north, range 4 west; thence due east to the southwest corner of the southeast quarter of the southeast quarter of section 27, the same

being the southwest corner of A. D. Fisher's claim; thence with said claim north to the northwest corner of the northeast quarter of the southeast quarter of said section 27; thence east to the section line between sections 26 and 27; thence north on said line to corner common to sections 22, 23, 26 and 27; thence east to Hood's Canal; thence southerly and easterly along said Hood's Canal to the place of beginning.

U. S. Grant."

VII.

Article 4 of said Treaty of January 26, 1855, reserved to the tribes of Indians, including the Skokomish Indian Tribe, certain fishing rights by the following language:

"Article 4. The right of taking fish at usual and accustomed grounds and stations is further secured to said Indians in common with all citizens of the United States; and of erecting temporary houses for the purpose of curing; together with the privilege of hunting and gathering roots and berries on open and unclaimed lands. Provided, However, That they shall not take shell-fish from any beds staked or cultivated by citizens."

VIII.

That it was the intent and purpose of the United States of America and the tribes of Indians executing said treaty of January 26, 1855, to encourage said tribes of Indians to reside at one place on a reservation to be set aside for their use and occu-

pancy, which was done by the Executive Order of President Grant, dated February 25, 1874. That the tracts of land so selected were to be sufficient for their wants as they then existed and continued to exist in the future.

IX.

That by virtue of said Executive Order of February 25, 1874, the uplands therein described together with the shorelands in the Hood's Canal became and were at all times reserved to the exclusive use, benefit and occupancy of the Skokomish Indian Tribe, together with the exclusive right for the use of the bed of Hood's Canal and all tidelands touching upon and bordering the reservation, and with the exclusive right as guaranteed by Article 4 of said Treaty of January 26, 1855, to fish in all the waters bordering upon the reservation as set out by said Executive Order, including the tidal waters thereof which border upon and touch said reservation.

X.

That the exclusive right of fishing was to be free from interference from the State of Washington, or any person or persons claiming under or by virtue of any title granted them by the state of Washington and subject only to the exclusive jurisdiction of the United States.

XI.

That by reason of the tidal waters flowing and ebbing in the Hood's Canal there are certain lands bordering upon the Reservation of the Skokomish

Indian Tribe as hereinabove described, which provide an excellent and profitable source of shell fish having a high commercial value.

XII.

That the State of Washington has granted by conveyance, lease, or otherwise, certain rights to the defendants herein named to the lands hereinafter described in, upon, over and across and through the tide-lands bordering upon the Skokomish Indian Reservation as hereinabove described. That said conveyance, grant, lease, or otherwise, and the defendants claiming the rights thereunder in conflict with the reserved rights of the plaintiff herein are described as follows:

The following defendants claim interest in the following described land:

E. L. France, Trustee, Carrie H. Klein, a widow, Clara B. Vance, Estate of E. S. Avey, Minnie E. Watson, W. H. France, Jane Doe France, E. L. France and Leo B. France, husband and wife. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the north half of tract two (2), lot three (3), section twenty-six (26), township twenty-two (22) north, range four (4) west, W.M., with a frontage of 5.13 lineal chains, more or less, measured along the meander line according to a certified copy of the government field notes of the survey thereof on file in the office of the Commissioner of Public Lands at Olympia, Washington.

The following defendants claim interest in the following described land: Ernest Carlson and Hulda S. Carlson, husband and wife, Potlatch Commercial and Terminal Company, a corporation. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the following described upland tracts, and extending to the line of extreme low tide: Tracts numbered ninety-nine (99) to one hundred two (102) inclusive; Tracts one hundred nine (109) and one hundred ten (110); Tracts one hundred thirteen (113) and one hundred fourteen (114) and Tracts one hundred sixteen to one hundred nineteen (116-119) inclusive, Potlatch Beach Tracts, according to the recorded plat thereof in the office of the Auditor for said County and State, Volume 4 of Plats, page 26, records of Mason County, Washington.

The following defendants claim interest in the following described land: George F. Wolf and Vivian A. Wolf, husband and wife, Potlatch Commercial and Terminal Company, a corporation. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the following described upland tracts, and extending to the line of extreme low tide; Tracts numbered one hundred three (103) and one hundred four (104), Potlatch Beach Tracts, according to the recorded plat thereof in the office of the Auditor for said County and State, Volume 4 of Plats, page 26, records of Mason County, Washington.

The following defendants claim interest in the following described land: Ralph E. Alexander and Adeline T. Alexander, husband and wife, Potlatch Commercial and Terminal Company, a corporation. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the following described upland tracts, and extending to the line of extreme low tide; Tracts numbered one hundred five, one hundred six, one hundred seven and one hundred eight (105, 106, 107 and 108), Potlatch Beach Tracts, according to the recorded plat thereof in the office of the Auditor for said County and State, Volume 4 of Plats, page 26, records of Mason County, Washington.

The following defendants claim interest in the following described land: Robert T. Sheldon and Lillian C. Sheldon, husband and wife, Allen M. Strine, Potlatch Commercial and Terminal Company, a corporation. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the following described upland tracts, and extending to the line of extreme low tide; Tracts one hundred eleven (111) and one hundred twelve (112), Potlatch Beach Tracts, according to the recorded plat thereof in the office of the Auditor for said County and State, Volume 4 of Plats, page 26, records of Mason County, Washington.

The following defendants claim interest in the following described land: Daniel R. Doran and

Florence Doran, husband and wife, Potlatch Commercial and Terminal Company, a corporation. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the following described upland tracts, and extending to the line of extreme low tide; Tract one hundred fifteen (115) Potlatch Beach Tracts, according to the recorded plat thereof in the office of the Auditor of Mason County, Washington, Volume 4 of Plats, page 26.

The following defendants claim interest in the following described land: Simpson Logging Company, City of Tacoma, a municipal corporation, George Simpson, Potlatch Commercial and Terminal Company, a corporation. All tidelands and shorelands of the second class, situate in front of, adjacent to or upon the Government Meander line, and extending to the line of extreme low tide, in front of Government Lot 1, Section 26, Township 22 North, Range 4 West, W.M., Except, that portion thereof conveyed to Ernest Carlson and Hulda S. Carlson, husband and wife, by deed dated June 2, 1941, filed June 23, 1941, as file No. 98452, and recorded in Volume 74 of Deeds, page 223, records of Mason County, Washington. Also known as Tax No. 266 except B, C, D and E; and Tax No. 266A, except A1, 2, 3, 4; containing 21.80 lineal chains.

The following defendants claim interest in the following described land: City of Tacoma, Pot-

latch Commercial Terminal Company, a corporation, State of Washington. Parcel 1: All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon that portion of the government meander line in front of the North one hundred (100) feet of Government Lot two (2), Section twenty-six (26), Township twenty-two (22) North, Range Four (4) West, W.M., and extending to the line of extreme low tide.

Parcel 2: All that certain tract of tide land of the second class lying between the Government Meander Line and the line of extreme low tide abutting upon Lot 2, Section 26, Township 22 North, Range 4 West, W.M., the location of which is particularly described as follows: Beginning at a point on the said meander line that is 100 feet distant, measured due south, from the North line of the said Lot 2; running thence by the courses of the said meander line South 40 deg. W., S. 4 deg. E., and South to a point thereon that is 906.8 feet distant, measured due south, from the said north line of Lot 2, being the tide land in front of said Lot 2, aforesaid, excepting a strip of 100 feet in width deducted on the north side of said Lot, and also a strip of 457.8 feet in width deducted on the south side of the same, containing 6 acres, more or less.

The following defendants claim interest in the following described land: George W. Willis and Grace F. Willis, husband and wife, John W. Phil-

lips and Jean S. Phillips, husband and wife, Ernest Worl and Beulah Worl, husband and wife. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon that portion of the government meander line in front of the south 460 feet measured along the west line of Indian Tract No. 2 of Government Lot 2, Section 26, Township 22 North, Range 4 West, W.M., and extending to the line of extreme low tide. Excepting therefrom, however, the following two portions:

1. A portion of the above as conveyed to George W. Willis and Grace F. Willis, husband and wife, by deed dated, January 20, 1947 and recorded in Volume 106 of Deeds, page 390, records of Mason County, Washington, described as follows: All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the following described upland, and extending to the line of extreme low tide; beginning at the intersection of the South line of said Government Lot 2 with the Easterly right-of-way line of Primary State Highway No. 9 (Olympic Highway); thence East along the south line of said Government Lot 2, to a point thereon which is 172 feet east from the center line of the existing pavement of said State Highway; thence due North $87\frac{1}{2}$ feet; thence Northeasterly 113 feet more or less, to a point on the Easterly line of said Government Lot 2 which is 134 feet northerly from the southeast corner of said Government Lot 2; thence northerly, along the easterly line of said

Government Lot 2, 80 feet; thence westerly to a point on the easterly right-of-way line of Primary State Highway No. 9 (Olympic Highway), which is 101 feet northerly thereon from the point of beginning; thence following along the easterly right-of-way line of said State Highway and in a southerly direction to the point of beginning.

2. A portion of the above as conveyed to John W. Phillips and Jean S. Phillips, husband and wife, by deed dated September 26, 1947, and recorded in Volume 113 of Deeds, page 60, records of Mason County, Washington, described as follows: All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the following described upland, and extending to the line of extreme low tide: A tract of land situated in Government Lot 2, and being a part of Indian Lot or Tract No. 2 in said Government Lot 2, Section 26, Township 22 North, Range 4 West, W.M., particularly described as follows: Beginning at a point on the south line of said Government Lot 2, which is 172 feet east from the center line of the existing pavement of Primary State Highway No. 9 (Olympic Highway); thence due North $86\frac{1}{2}$ feet; thence northeasterly 113 feet, more or less, to a point on the Easterly line of said Government Lot 2 which is 134 feet northerly from the southeast corner of said Government Lot 2; thence southerly along the easterly line of said Government Lot 2, 134 feet to the southeast corner of said Government Lot 2, thence west, along the south line of said Government Lot 2, to the point of beginning.

The following defendants claim interest in the following described land: George W. Willis and Grace F. Willis, husband and wife, Potlatch Commercial Terminal Company, a corporation. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the following described upland, and extending to the line of extreme low tide: Beginning at the intersection of the south line of said Government Lot 2 with the easterly right-of-way line of Primary State Highway No. 9 (Olympic Highway); thence east along the south line of said Government Lot 2, to a point thereon which is 172 feet east from the center line of the existing pavement of said State Highway; thence due North $86\frac{1}{2}$ feet; thence northeasterly 113 feet more or less; to a point on the easterly line of said Government Lot 2 which is 134 feet northerly from the southeast corner of said Government Lot 2; thence northerly, along the easterly line of said Government Lot 2, 80 feet; thence westerly to a point on the easterly right-of-way line of said Primary State Highway No. 9 (Olympic Highway), which is 101 feet northerly thereon from the point of beginning; thence following along the easterly right-of-way line of said State Highway and in a southerly direction to the point of beginning.

The following defendants claim interest in the following described land: John W. Phillips and Jean S. Phillips, husband and wife, Potlatch Commercial Terminal Company, a corporation, Seattle

First National Bank. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the following described upland, and extending to the line of extreme low tide: A tract of land situated in Government Lot 2, and being a part of Indian Lot or Tract No. 2 in said Government Lot 2, Section 26, Township 22 North, Range 4 West, W.M., particularly described as follows: Beginning at a point on the south line of said Government Lot 2, which is 172 feet east from the center line of the existing pavement of Primary State Highway No. 9 (Olympic Highway); thence due north $86\frac{1}{2}$ feet; thence northeasterly 113 feet, more or less, to a point on the easterly line of said Government Lot 2, which is 134 feet northerly from the southeast corner of said Government Lot 2; thence southerly, along the Easterly line of said Government Lot 2, 134 feet to the southeast corner of said Government Lot 2, thence west, along the south line of said Government Lot 2, to the point of beginning.

The following defendants claim interest in the following described land: Phoenix Logging Company, Potlatch Commercial and Terminal Company, a corporation. All that portion of the following described tidelands, as may lie in front of, adjacent to or abutting upon the Government Meander line of Government Lot 3, Section 26, Township 22 North, Range 4 West: All tidelands and shorelands of the second class, formerly owned by

the State of Washington, situate in front of, adjacent to or abutting upon the Government Meander line and extending to the line of extreme low tide, as follows: Beginning at the meander corner to fractional sections twenty-three (23) and twenty-four (24), Township twenty-two (22) north, range four (4) west, W.M., and running thence south $33\frac{1}{4}^{\circ}$ west, 4.20 chains; south $60\frac{1}{4}^{\circ}$ west, 6.80 chains; south 67° west, 3.90 chains; south $70\frac{1}{4}^{\circ}$ west, 13.50 chains; south 40° west, 10.30 chains; south 4° east, 9.00 chains; south 8.00 chains and south $36\frac{1}{4}^{\circ}$ east, 4.00 chains to the terminal point of this description, with a frontage of 59.70 lineal chains.

The following defendants claim interest in the following described land: C. H. Everett and Lillian Everett, husband and wife, Potlatch Commercial and Terminal Company, a corporation, Walter C. Asen and Lorraine Asen. All tidelands of the second class in front of, adjacent to or abutting upon that part of Tract One A of Lot 3, Section 26, Township 22 North, Range 4 West, W.M., measured along the meander line as follows: Beginning at the meander corner to fractional Sections 23 and 26, Township 22 North, Range 4 W., W.M., and running thence south $33\frac{1}{4}^{\circ}$ west 4.20 chains; south $60\frac{1}{4}^{\circ}$ West 6.80 chains; south 67° West 3.90 chains; south $70\frac{1}{4}^{\circ}$ West 13.50 chains; south 4° West 10.30 chains; south 4° East 9.00 chains; south 8 chains and south $36\frac{1}{4}^{\circ}$ east 4.00 chains to the true point of beginning of this de-

scription; thence south $36\frac{1}{4}^{\circ}$ east 4.89 chains more or less to the intersection of the south line of said Tract One A with the meander line and the terminal point of this description with a frontage of 4.89 lineal chains more or less measured along the meander line.

The following defendants claim interest in the following described land: Luella L. Greeley, F. G. Chapman. All tidelands of the second class formerly owned by the State of Washington, as defined by Section 1 of Chapter 36 of the Session Laws of 1911, situate in front of, adjacent to or abutting upon the following described upland: The north one-third ($\frac{1}{3}$) of Indian Tract No. 1-B in Government Lot three (3), Section twenty-six (26), Township twenty-two (22) North, Range four (4) West, W.M., (being a portion of Indian Tract No. 9-B Jennie Pulsifer allottee), and being the north one-third of a tract of land conveyed by Thomas Pulsifer, sole heir of Jennie Pulsifer, deceased Skokomish allottee, No. 9-B L.H. 43315-14 of the Skokomish Indian Reservation, a non-competent Skokomish Indian, to F. G. Chapman, the deed being recorded in Volume 45 of Deeds, page 247. Except, all tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the south twenty (20) feet of the above described upland.

The following defendants claim interest in the following described land: Carl J. Macke and Flor-

ence Macke, husband and wife, F. G. Chapman.

Parcel 1: All second class tidelands lying in front of, adjacent to or abutting upon the following described upland: the north one-half of the south two-thirds of Tract 1-B of Lot Three in Section twenty-six in Township twenty-two north, Range four West of W.M., excepting Olympic Highway right-of-way, excepting area conveyed to City of Tacoma, and excepting all ditches and canals constructed by authority of the United States, it being understood that this deed conveys the central or middle one-third of a tract to above grantors by deed recorded in Book 45 of Deed records of Mason County, at page 247 thereof, and subject thereto.

Parcel 2: All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon the south twenty (20) feet of the following described upland: The North one-third ($\frac{1}{3}$) of Indian Tract No. 1-B in Government Lot three (3), Section twenty-six (26), Township twenty-two (22) north, range four (4) west, W.M., (being a portion of Indian Tract No. 9-B, Jennie Pulsifer allottee), and being the north one-third ($\frac{1}{3}$) of a tract of land conveyed by Thomas Pulsifer, sole heir of Jennie Pulsifer, deceased Skokomish allottee, No. 9-B L.H. 43315-14 of the Skokomish Indian Reservation, a non-competent Skokomish Indian to F. G. Chapman, the deed being recorded in Volume 45 of Deeds, page 247.

The following defendants claim interest in the following described land: F. G. Chapman and Bertha A. Chapman, husband and wife. All tidelands of the second class, owned by the State of Washington, situate in front of, adjacent to or abutting upon Tract 1-B, Lot 3, Section 26, Township 22 North, range 4 West, W.M., with a frontage of 5.36 lineal chains, more or less, measured along the meander line according to a certified copy of the government field notes of the survey thereof on file in the office of the Commissioner of Public Lands at Olympia, Washington. Except: All tidelands of the second class in front of, adjacent to or abutting upon the following described upland: The North one-third of Tract 1-B of Lot Three, in Section twenty-six, Township twenty-two North, Range Four West of W.M. Also excepting—All tidelands of the second class, lying in front of, adjacent to or abutting upon the following described upland: The North One-Half of the South Two-Thirds of Tract 1-B of Lot Three in Section Twenty-six in Township Twenty-two North, Range Four West of W.M.

The following defendants claim interest in the following described land: Fred Hanson, Wallace O. Hanson, Buster F. Hanson, Olympia F. Kern, Agnes Granger, Alice Hanson. All tidelands of the second class, owned by the State of Washington, situate in front of, adjacent to or abutting upon the south half of tract 2, lot 3, section 26, township 22 north, range 4 west, W.M., with a frontage of 5.06 lineal chains, more or less, measured along

the government meander line. All tidelands of the second class, owned by the State of Washington, situate in front of, adjacent to or abutting upon that part of Lot 4, section 26, township 22 north, range 4 west, W.M., measured along the meander line as follows: Beginning at the meander corner to fractional sections twenty-six (26) and thirty-five (35) Township twenty-two (22) north, range four (4) west W.M., and running thence N 20° E 4.60 chains, N 80° E 8.10 chains and N 42° E 3.80 chains to the true point of beginning of this description; thence running N 5° W 9.00 chains and N 9° west 2.56 chains more or less, to the point of intersection of the north line of said lot four (4) with said meander line with a frontage of 11.56 lineal chains, more or less, measured along the meander line according to a certified copy of the Government field notes on the survey on file in the office of the Commissioner of Public Lands at Olympia, Washington.

The following defendants claim interest in the following described land: The Casco Company, a Washington corporation, Millard Lemon, J. T. Thacker, Lola F. Falknor, A. J. Falknor, Annie P. Thacker, Fred Barnes, Wanda Barnes, N. Ward, Frank Ward, Sidney Ward, Lawrence Ward. All tidelands of the second class, as conveyed by the State of Washington, situate in front of, adjacent to or abutting upon that portion of the government meander line, and extending to the line of extreme low tide, described as follows: Beginning

at the meander corner to fractional sections 26 and 35, township 22 North, range 4 West, W.M., and run thence with the meanders in front of Lot 4, Section 26, as follows: North 20° East 4.60 chains; North 80° East 8.10 chains; North 42° East 3.80 chains to the terminal point of this description and having a total frontage of 16.50 lineal chains, more or less, measured along the meander line, according to a certified copy of the government field notes of the survey thereof on file in the office of the Commissioner of Public Lands at Olympia, Washington.

The Casco Company, a Washington corporation, A. J. Falknor, Millard Lemon, State of Washington, Annie P. Thacker. All tidelands of the second class suitable for the cultivation of oysters described by meets and bounds as follows, to-wit: Beginning at corner #1, a stake identical with the meander corner to fractional sections 26 and 35, township 22 north, range 4 west of W.M., marked and witnessed as described in the government field notes; thence south 16 deg. 20' west 7.03 chs. to corner #2, a stake identical with the N.E. corner of the Skokomish Indian Reservation in said section 35; thence S. 9 deg. 50' east 3.04 chs. to corner #3; thence S. 16 deg. 00' west 9.72 chs. to corner #4, whence a stake bears west 52 links distant; thence S. 16 deg. 00' E. 5.01 chs. to corner #5; thence S. 16 deg. 30' W. 4.91 chs. to corner #6; thence S. 32 deg. E. 11.85 chs. to corner #7, whence a stake and mound of stone bears S. 48 deg.

11' W. 51 links distance; thence S. 51 deg. 00' E. 23.91 chs. to corner #8, whence a post and mound of stone bears S. 50 deg. 25' E. 8.10 chs. distant; also the northeast corner of lot 22 in said section 35 bears S. 48 deg. 06' E. 20.21 chs. distant; thence S. 54 deg. 00' E. 6.52 chs. more or less, to intersection with the north boundary of State Oyster Reserve, and corner #9; thence east along the north boundary line of said Oyster Reserve 8.50 chs. to corner #10; thence N. 53 deg. 01' W. 4.97 chs. more or less, to corner #11, whence the northeast corner of lot 22 heretofore described, bears S. 23 deg. 21' E. 14.15 chs. distant; thence N. 49 deg. 02' W. 18.05 chs. to corner #12; thence N. 31 deg. 53' W. 23.02 chs. to corner #13; thence N. 11 deg. 29' W. 23.64 chs. to place of beginning, containing 46.302 acres, more or less, as shown by the plat and field notes of the survey thereof on file in the office of the Commissioner of Public Lands at Olympia, Washington.

The following defendants claim interest in the following described land: State of Washington. A strip of land, same being all that part of the hereinafter described shorelands which lie west of a line drawn parallel to and 50 feet east of the center line of State Road No. 9 as said road is now surveyed over and across the following described property in the County of Mason, State of Washington:

Beginning at corner #1, a stake identical with the meander corner to fractional sections 26 and 35, Township 22 North, Range 4 West, W.M., marked

and witnessed as described in the Government Field Notes; thence South $16^{\circ} 20'$ West 7.03 chains to corner #2, a stake identical with the Northeast corner of the Skokomish Indian Reservation in said Section 35; thence South $9^{\circ} 50'$ East 3.04 chains to corner #3; thence South $16^{\circ} 00'$ West 9.72 chains to corner #4; whence a stake bears West 52 links distant; thence South $16^{\circ} 00'$ East 5.01 chains to corner #5; thence South $16^{\circ} 30'$ West 4.91 chains to corner #6; thence South $32^{\circ} 00'$ East 11.85 chains to corner #7; whence a stake and mound of stone bears South $48^{\circ} 11'$ West 51 links distant; thence South $51^{\circ} 00'$ East 23.91 chains to corner #8, whence a post and mound of stone bears South $50^{\circ} 25'$ East 8.10 chains distant; also the Northeast corner of Lot 22 in said Section 35 bears South $48^{\circ} 06'$ East 20.21 chains distant; thence South $54^{\circ} 00'$ East 6.52 chains, more or less, to intersection with the North boundary of State Oyster Reserve and corner #9; thence East along the North boundary line of said oyster reserve 8.50 chains to corner #10; thence North $53^{\circ} 01'$ West 4.97 chains, more or less, to corner #11; whence the Northeast corner of Lot 22 heretofore described bears South $23^{\circ} 21'$ East 14.15 chains distant; thence North $49^{\circ} 02'$ West 18.05 chains to corner #12; thence North $31^{\circ} 53'$ West 23.00 chains to corner #13; thence North $11^{\circ} 29'$ West 23.64 chains to place of beginning, containing 46.302 acres, more or less, as shown by the plat and field notes of the survey thereof on file in the office of the Commissioner of Public Lands at Olympia, Washington.

The following defendants claim interest in the following described land: The Casco Company, a Washington corporation, A. J. Falknor, State of Washington. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon Lots 1 and 2, Section 35, Township 22 North, Range 4 West, W.M., with a total frontage of 19.39 lineal chains, more or less. Excepting those portions of the above described tidelands included in a tract of oyster land in front of said section 35, deeded by the State of Washington to A. J. Falknor, March 26, 1906, under application No. 3356.

The following defendants claim interest in the following described land: State of Washington, James J. Smith. The vacated State Oyster Reserve Plat No. 134 in front of Section 35, Township 22 North of Range 4 West, W.M., Mason County, Washington, described as follows:

Beginning at the meander corner on the south line of said Section 35 and running thence N. 20° W. 9.00 chains; thence N. 57° W. 14.00 chains; thence N. 64° W. 8.94 chains; thence East 8.74 chains; thence S. 77° 15' E. 13.04 chains; thence S. 53° E. 10.40 chains; thence South 11.00 chains and West 7.00 chains to the point of beginning and having an area of 22.68 acres.

The following defendants claim interest in the following described land: State of Washington. All tidelands situate in front of, adjacent to or abutting upon Government Lots 3, 4 and 5, Section

35, Township 22 North of Range 4 West, W.M., Mason County, Washington, except those portions of the above described tidelands included in the following oyster land tracts lying in front thereof:

1. Deeded to Homer Thacker, Lola Falknor and Jessie M. Hopkins, dated March 26, 1906, under Application No. 3513, recorded in Volume 9 O.L. page 21, records of Mason County, Washington.

2. Deeded to A. J. Falknor, dated March 26, 1906, under Application No. 3356, recorded in Volume 8 O.L. Page 334, records of Mason County, Washington.

3. Vacated Oyster Reserve Plat No. 134 (not conveyed, but vacated January 13, 1930).

The following defendants claim interest in the following described land: The Casco Company, a Washington corporation, Homer Thacker, Lola Falknor, Jessie M. Hopkins, State of Washington, Annie P. Thacker. All tidelands of the second class suitable for the cultivation of oysters described by metes and bounds as follows, to-wit:

Beginning at the initial point, corner #1, identical with the Southeast corner of the State Oyster Reserve Plat #134 and from which the meander corner to sections 2 and 35, township 21 and 22 north, range 4 West, W.M., bears west 7.00 chs. distant; thence from said initial point N. 89 deg. 10' E. 15.27 chs. to corner #2; thence S. 60 deg. east 6.44 chs. to corner #3; thence S. 63 deg. 30' E. 18.88 chs. to corner #4; thence N. 85 deg. E. 11.31 chas. to corner #5 from which the corner to Sections 1, 12, 6 and 7, township 21 north, range 3

and 4 west bears S. 24 deg. 13' E. 77.588 chs. distant; thence N. 43 deg. 15' W. 10.70 chs. to corner #6; thence N. 61 deg. 23' W. 14.719 chs. to corner #7; thence N. 88 deg. 36' W. 13.503 chs. to corner #8; thence N. 67 deg. 38' W. 16.504 chs. to corner #9; thence S. along the east line of State Oyster Reserve a distance of 11 chains to corner #1 and place of beginning, containing 39.61 acres, more or less, according to the map and field notes of the survey thereof on file in the office of the Commissioner of Public Lands at Olympia, Washington.

The following defendants claim interest in the following described land: State of Washington. All tidelands situate in front of, adjacent to or abutting upon Government Lot 1, Section 2 and Government Lots 1 and 2, Section 1, Township 21 North, Range 4 West, W.M., Mason County, Washington, except those portions of the above described tidelands included in the following oyster land tracts lying in front thereof.

1. Deeded to Homer Thacker, Lola Falknor and Jessie M. Hopkins, dated March 26, 1906, under Application No. 3513, recorded in Volume 9 O.L. Page 21, records of Mason County, Washington.

2. Vacated Oyster Reserve Plat No. 134 (not conveyed, but vacated January 13, 1930).

The following defendants claim interest in the following described land: Marcus Nalley and Frances Nalley, husband and wife, E. A. Sims, Charles T. Wright, Paul Hunter and Jane Doe

Hunter, his wife. All tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon Lot 3, Section 1, Township 21 North, Range 4 West, W.M., with a frontage of 12.50 lineal chains, more or less, measured along the government meander line (also known as Assessor's Tax #911).

The following defendants claim interest in the following described land: Marcus Nalley and Frances Nalley, husband and wife, Frank A. Robinson, City of Tacoma. All tidelands of the second class, formerly owned by the state of Washington, situate in front of, adjacent to or abutting upon Government Lot 4, Section 1, Township 21 North, Range 4 West, W.M., with a frontage of 25.74 lineal chains, more or less, measured along the Government meander line. (Also known as Assessor's Tax No. 899).

The following defendants claim interest in the following described land: State of Washington, City of Tacoma, Charles T. Wright, Paul Hunter and Jane Doe Hunter, his wife. All of the tidelands of the second class, owned by the State of Washington, situate in front of, adjacent to or abutting upon Lots 1 and 2, Section 6, Township 21 North, Range 3 West, W.M., and the detached tidelands lying to the East of said Lot. (See note.)

Note: It is assumed that Lot 1 above described refers to Indian Lot 1 (being fractional Northwest Quarter of Southwest Quarter (NW $\frac{1}{4}$ SW $\frac{1}{4}$))

and that Lot 2 above described refers to Indian Lot 2 (being fractional Southwest Quarter of Southwest Quarter ($SW\frac{1}{4}$ of $SW\frac{1}{4}$) of Section 6, Township 21 North, Range 3 West, W.M.

The following defendants claim interest in the following described land: State of Washington. All of the tidelands of the second class, owned by the State of Washington, situate in front of, adjacent to, or abutting upon Lot 1, Section 7, Township 21 North, Range 3 West, W.M., and the detached tidelands lying to the East of said lot. (See note.)

Note: It is assumed that Lot 1 above described refers to Indian Lot 1 (being in fractional Northwest Quarter of Northwest Quarter ($NW\frac{1}{4}$ of $NW\frac{1}{4}$) of Section 7, Township 21, North, Range 3 West, W.M.

The following defendants claim interest in the following described land: City of Tacoma, Charles T. Wright, Paul Hunter and Jane Doe Hunter, his wife.

A. Existing electric transmission line over and across all tidelands of the second class, formerly owned by the State of Washington, situate in front of, adjacent to or abutting upon Government Lot 4, Section 1, Township 21 North, Range 4 West, W.M., with a frontage of 25.74 lineal chains, more or less, measured along the Government meander line. (Also known as Assessor's Tax No. 899).

B. Existing electric transmission line over and

across all of the tidelands of the second class, owned by the State of Washington, situate in front of, adjacent to or abutting upon Lot 1, Section 6, Township 21 North, Range 3 West, W.M., and the detached tidelands lying to the East of said Lot. (See note.)

Note: A portion of the above Electric Transmission Line and the right-of-way lies within the limits of a public shooting ground as laid out on detached tidelands in front of Government Lot 3 and Indian Lot 1, Section 6, Township 21 North, Range 3 West, W.M., and fully described.

The following defendants claim interest in the following described land: United States of America (Bonneville Power Administration), Charles T. Wright, Paul Hunter and Jane Doe Hunter, his wife. Right of way for electric transmission line over and across all of the tidelands of the second class, owned by the State of Washington, situate in front of, adjacent to or abutting upon Lot 1, Section 6, Township 21 North, Range 3 West, W.M., and the detached tidelands lying to the east of said lot. (See note.)

Note: The tideland plat in the Office of the Commissioner of Public Lands at Olympia, Wash., shows as follows: "R/W App. 17450, Bonneville Power Adm. rejected 5/23/45", adjacent to Indian Lot 1, Section 6, Township 21 North, Range 3 West, WM.

The following defendants claim interest in the following described land: State of Washington,

City of Tacoma, Charles T. Wright, Paul Hunter, and Jane Doe Hunter, his wife. The detached tidelands of the second class, owned by the State of Washington, included within the limits of a tract described as follows:

Beginning at a point in front of Section 6, Township 21 north, Range 3 West, W.M., which is S 44° 30' W 920 feet distant from the meander corner of the north line of said section and running thence S 40° 10' E 1073.5 feet, S 13° 10' W 1269.7 feet, S 74° 40' W 670 feet and S 27° 32' W 1125 feet to a point which is N 45° 50' E 1932 feet distant from the southwest corner of said section 6; thence N 90° 30' W 3530 feet and east 1960 feet to said point of beginning, containing an area of 104.68 acres according to the plat thereof on file in the Office of the Commissioner of Public Lands at Olympia, Washington. (Also known as Assessor's Tax #1176.)

XIII.

That the rights of the plaintiff herein, the Skokomish Indian Tribe, by virtue of the reservation granted to them in said Treaty of January 26, 1855, are paramount and superior to any right or to any title of whatsoever nature granted to the defendants hereinabove described, or to any rights in and to the lands described above, which lands are tidelands, and that the title of the plaintiff, the Skokomish Indian Tribe, in and to said tidelands as hereinabove described, should be quieted in said plaintiff, the Skokomish Indian Tribe, and the rights of the defendants and any persons claiming by,

through, or under them, should be forever barred and declared to be invalid and without any legal effect by any grant from the state of Washington.

Wherefore, plaintiff prays—

1. That this Court quiet title of said plaintiff in and to the above-described lands, and that the defendants herein be forever barred and estopped from claiming any right or title in and to said lands.

2. That this Court grant further and necessary relief to effect and remove said defendants from said lands and to determine and define the rights of the plaintiffs herein in and to said lands.

3. For such further and equitable relief that this Court may deem proper.

KENNETH R. L. SIMMONS and
EDWIN C. DAVIS,

/s/ By KENNETH R. L. SIMMONS,
KEITH & WINSTON,

/s/ By P. H. WINSTON,
Attorneys for Plaintiff.

[Endorsed]: Filed December 3, 1948.

[Title of District Court and Cause.]

STIPULATION

It is hereby Stipulated and Agreed that the above entitled action be dismissed as to the United States of America, therein named as a defendant, and that

an order of dismissal as to said defendant United States of America may be entered without costs to either party as against the other.

This stipulation is made upon the mutual understanding that the Bonneville Power Administration has no interest in the tract of land described on page 18 of plaintiff's complaint, which description by reference is made a part hereof; that heretofore an application was made to the Washington State Public Land Commissioner for a right-of-way easement over the bed of the Skokomish River and tide lands fronting Section 6, Township 21 North, Range 3 West, Willamette Meridian in Mason County, Washington, being application No. 17540, on February 21, 1942; that program readjustments due to war conditions caused said administration to abandon its plans for the construction of the line projected for said location and on April 23, 1945 the Washington State Public Lands Commissioner was notified that the Administration wished to withdraw its application, and that pursuant to said notice the said commissioner rejected said application by order dated May 23, 1945, and that accordingly the United States of America has no right, title, or interest in or to said premises, or any interest in the above entitled action.

Dated this 17th day of February, 1949.

/s/ LYLE KEITH,

/s/ P. H. WINSTON,

/s/ KENNETH R. L. SIMMONS,

Of Counsel for Plaintiff.

/s/ J. CHARLES DENNIS,
United States Attorney,

/s/ GUY A. B. DOVELL,
Assistant United States Attorney.

[Endorsed]: Filed February 18, 1949.

[Title of District Court and Cause.]

AMENDED MOTION TO DISMISS

The defendant, Chas. T. Wright, moves the court as follows:

I.

To dismiss the action or in lieu thereof to suspend the action on the ground that there is now pending a prior action in the Superior Court of the State of Washington in and for the County of Mason.

That this amended motion is based upon attached Summons and Complaint certified by the County Clerk of Mason County, State of Washington, and the files and records of this action.

B. FRANKLIN HEUSTON,
GLENN E. CORREA,
J. W. GRAHAM,

/s/ By B. FRANKLIN HEUSTON,
Of Counsel for Defendant,
Chas. T. Wright.

[Endorsed]: Filed February 21, 1949.

[Title of District Court and Cause.]

ORDER DISMISSING U.S.A.
AS PARTY DEFENDANT

This matter coming on this 17th day of March, 1949, upon application of defendant, United States of America for an order dismissing said United States of America as a party defendant, and it appearing to the court from the stipulation herein filed by counsel for plaintiff, and for defendant, U.S.A., that the United States of America has no interest in the property described in plaintiff's complaint, and is not a proper or necessary party to this action, and that the same should be dismissed as to the United States of America, now, therefore, it is hereby

Ordered, Adjudged and Decreed that the above entitled action be and the same hereby is dismissed as to the United States of America, without cost to either party as against the other.

Done in Open Court this 17th day of March, 1949.

/s/ JOHN C. BOWEN,
United States District Judge.

Approved:

/s/ LYLE KEITH,
/s/ P. H. WINSTON,
/s/ KENNETH R. L. SIMMONS,
Of Counsel for Plaintiff.

Presented by:

/s/ GUY A. B. DOVELL,

Assistant United States Attorney,

/s/ J. CHARLES DENNIS,

United States Attorney.

[Endorsed]: Filed March 17, 1949.

[Title of District Court and Cause.]

MOTION TO DISMISS

Come now defendants F. G. Chapman and Bertha A. Chapman, and move the court to dismiss the above entitled action on the following grounds, to wit:

1. That another action is pending between the same parties for the same cause in the Superior Court of the State of Washington for Mason County.

2. That the complaint does not state facts sufficient to constitute a cause of action against the said defendants.

3. That the plaintiff has been guilty of laches and has thereby waived any rights it may at any time have claimed or possessed.

4. That the State of Washington, predecessor in interest of defendants, has been in open, notorious, exclusive and continuous possession of the tide lands involved in this action under a claim of own-

ership for a period of over 60 years as a state, and prior thereto as a territory and that said possession and claim of ownership has been adverse to the plaintiff.

6. That the action has not been commenced within the time limited by law.

/s/ J. W. GRAHAM,

Attorney for Defendants Chapman.

Acknowledgment of Service Attached.

[Endorsed]: Filed May 23, 1949.

[Title of District Court and Cause.]

NOTICE OF APPEARANCE

To: The Skokomish Indian Tribe, Plaintiff, and to Kenneth T. L. Simmons, Edwin C. Davis, Lyle Keith and P. H. Winston, plaintiff's attorneys:

You, and Each of You, are hereby notified that the above named defendant, State of Washington, hereby enters its appearance in the above entitled action by and through its attorneys, Smith Troy, Attorney General, T. H. Little, Chief Assistant Attorney General, and E. P. Donnelly, Assistant Attorney General, and requests that all further pleadings herein be served upon said defendant at the office of the Attorney General in the Temple of Justice, Olympia, Thurston County, Washington.

Dated this 9th day of May, 1949.

/s/ SMITH TROY,

Attorney General,

/s/ T. H. LITTLE,

Chief Assistant Attorney General,

/s/ E. P. DONNELLY,

Assistant Attorney General.

Acknowledgment of Service Attached.

[Endorsed]: Filed July 14, 1949.

[Title of District Court and Cause.]

MOTION TO DISMISS

Come now the above named defendants, Marcus Nalley and Frances Nalley, husband and wife, and move the Court as follows:

1. To dismiss the action because the complaint fails to state a claim against these defendants upon which relief can be granted.

2. To dismiss the action on the ground that the Court lacks jurisdiction over the subject matter of the action and the person of the plaintiff in that there is no allegation that the amount actually in controversy between the plaintiff and these defendants exceeds, exclusive of interest and costs, the sum of \$3,000.00, and because the plaintiff does not have capacity to sue and maintain the action, in that plaintiff is an Indian tribe and is not repre-

sented by the Government of the United States of America and is not represented by the United States District Attorney as is required by law.

/s/ S. W. Z. HENDERSON,
HENDERSON, CARNAHAN &
THOMPSON AND H. C.
PERKINS,

Attorneys for defendants, Marcus Nalley and Frances Nalley, husband and wife.

Acknowledgment of Service Attached.

[Endorsed]: Filed August 17, 1949.

[Title of District Court and Cause.]

MOTION TO DISMISS

Come now the defendants Ernest Worl and Beulah Worl, his wife, John W. Phillips and Jean S. Phillips, his wife, Allen M. Strine, Walter Asen and Lorraine Asen, his wife, Ernest Carlson and Hulda S. Carlson, his wife, Seattle First National Bank of Shelton, Washington, George W. Willis and Grace F. Willis, his wife, Carl J. Macke and Florence Macke, his wife, George F. Wolf and Vivian A. Wolf, his wife, Luella L. Greeley and Daniel R. Doran and Florence Doran, his wife, by their attorneys, and move this Court to dismiss the action on the following grounds:

I.

The complaint fails to state a claim against said

defendants or any of them upon which relief can be granted.

II.

This Court lacks jurisdiction over the subject matter of the action.

III.

This Court lacks jurisdiction over said defendants in this action.

IV.

Plaintiff lacks capacity to bring this action.

V.

The complaint shows on its face that the action was not brought within the time limited by law.

Dated this 20th day of December, 1949.

SKEEL, McKELVEY, HENKE,

EVENSON & UHLMANN,

/s/ By ROBERT S. IVIE,

Attorneys for above-named

Defendants.

Acknowledgment of Service Attached.

[Endorsed]: Filed December 28, 1949.

[Title of District Court and Cause.]

MOTION TO DISMISS

The defendant State of Washington moves that the court enter an order dismissing the cause of action as to the State of Washington on the following ground:

1. The court possesses no jurisdiction over the State of Washington.

We have attached Memorandum Brief.

/s/ SMITH TROY,
Attorney General,
/s/ E. P. DONNELLY,
Assistant Attorney General,
/s/ ROBERT A. COMFORT,
Assistant Attorney General,
Attorneys for the State of
Washington.

[Endorsed]: Filed April 27, 1951.

[Title of District Court and Cause.]

MEMORANDUM BRIEF IN FAVOR OF RESPONDENT STATE OF WASHINGTON'S MOTION TO DISMISS

The Eleventh Amendment to the Constitution of the United States reads as follows:

“The judicial power of the United States shall not be construed to extend to any suit in

law or equity, commenced or prosecuted against one of the United States by citizens of another state or by citizens or subjects of any foreign state."

Because of this amendment the Federal courts are without jurisdiction to entertain a suit instituted by private parties against a state in the absence of any consent by the state. *Ford Motor Company v. Department of Treasury of the State of Indiana*, 323 U. S. 459, 89 L. ed. 389, 65 S. Ct. 347.

The Skokomish Indians are citizens of the United States and of the State of Washington. See Title 8, section 601, p. 597, U.S.C.A. Though the Eleventh Amendment only explicitly refers to "citizens of another state or * * * citizens or subjects of any foreign state," it also applies to a suit brought against a state by one of its own citizens. *Hans v. Louisiana*, 134 U. S. 1, 33 L. ed. 842, 10 S. Ct. 504; *Ex Parte Young*, 209 U. S. 123, 150, 52 L. ed. 714, 28 S. Ct. 441. In the former case, the plaintiff, a citizen of Louisiana, was suing his home state in a Federal court. The Supreme Court held that even though a case arises under the Constitution and Laws of the United States, the Circuit (now District) Court was without jurisdiction to entertain a suit maintained by a citizen against his own state. By analogy, even though the case at bar arises under a treaty of the United States, this court is without jurisdiction to entertain the suit for it is brought by a party against his own state.

Nor does the fact that the plaintiff has been in-

corporated under Federal law confer jurisdiction upon this court. The same principle that protects states against suits in a Federal court by citizens of that state, also prohibits the institution of suits in a Federal court by a Federal corporation against a state. In the case of *Principality of Monaco v. Mississippi*, 292 U. S. 313, 78 L. ed. 1282, 54 S. Ct. 745, on page 329 of the U. S. Reports the following appears:

“The states, in the absence of consent are immune from suits brought by their own citizens or by federal corporations, although such suits are not within the explicit prohibitions of the Eleventh Amendment.”

The right of private parties to sue a state lies not in the Constitution or Laws of the United States, but can only come from the consent of the state. *Palmer v. Ohio*, 248 U. S. 32, 63 L. ed. 108, 39 S. Ct. 16. The State of Washington has not consented to this suit. Laws of 1895, p. 188, section 1, as amended by Laws of 1927, p. 331, section 1 (Rem. Rev. Stat. 886), reads in part as follows:

“* * * actions * * * to determine or quiet title to, any real property in which the State of Washington is a necessary or proper party defendant may be commenced and prosecuted to judgment against the state in the superior court of the county in which such real property is situated, * * *.” (Emphasis supplied.)

Patently, the Washington legislature contemplated the institution of suits against the state in state

courts and did not authorize the institution of such suits in a Federal court. This statute waiving the State of Washington's immunity from suit cannot be construed as waiving the immunity from suit in a Federal court. *Ford Motor Company v. Department of Treasury of the State of Indiana*, *supra*.

The principles of law above cited are well established. It is felt by the defendant State of Washington that they sufficiently support the contention that the plaintiff's case should be dismissed as to the State of Washington.

Respectfully submitted,

SMITH TROY,
Attorney General,
E. P. DONNELLY,
Assistant Attorney General,
ROBERT A. COMFORT,
Assistant Attorney General,
Attorneys for the State of
Washington.

[Endorsed]: Filed April 27, 1951.

[Title of District Court and Cause.]

MOTION TO DISMISS OF DEFENDANTS
SIMPSON LOGGING COMPANY, ET AL.

Come now the defendants Simpson Logging Company, for itself and as the successor to the defendant Phoenix Logging Company, and Frances C.

Simpson, heir of George Simpson, deceased, and move the Court to dismiss the action above entitled upon the following grounds:

I.

The complaint fails to state claim against said defendants or any of them upon which relief can be granted.

II.

This Court lacks jurisdiction of the subject matter of the action.

III.

This Court lacks jurisdiction over said defendants in this action.

IV.

Plaintiff lacks capacity to bring this action.

V.

The complaint shows on its face that the action was not brought within the time limited by law.

VI.

The plaintiff has been guilty of laches and has waived any rights it may have at any time possessed in the matter.

Dated this 14th day of May, 1951.

/s/ WILLIAM D. ASKREN,

RYAN, ASKREN & MATHEWSON,

Attorneys for said Defendants.

Receipt of Copy Acknowledged.

[Endorsed]: Filed June 4, 1951.

[Title of District Court and Cause.]

MEMORANDUM OPINION AND ORDER DENYING MOTIONS TO DISMISS COMPLAINT

The plaintiff, in its complaint filed herein December 3, 1948, alleges that it is an Indian Tribe duly incorporated and acting pursuant to its corporate charter and constitution and by-laws and has authorized its attorneys to bring this action. Jurisdiction of this court is alleged to arise from the fact that plaintiff is an incorporated Indian Tribe and that the rights desired to be protected arise out of an Indian Treaty and that the amount in controversy exceeds, exclusive of interest and costs, the sum of \$3,000. The complaint further alleges the Treaty with the Indians under date of January 26, 1855, which Treaty included the Skokomish Indian Tribe. It also alleges the Executive Order of February 25, 1874 by which President Grant set aside the present Skokomish Indian Reservation at the head of Hood's Canal. The complaint further alleges that by virtue of the Executive Order of February 25, 1874 the uplands therein described, together with the shorelands in the Hood's Canal, became and were at all times reserved to the exclusive use, benefit and occupancy of the Skokomish Indian Tribe with the exclusive right, as guaranteed by said Treaty, to fish in all the waters bordering upon the reservation, including the tidal waters thereof which border upon and touch said reserva-

tion. The complaint further alleges that the exclusive right of fishing was to be free from interference from the State of Washington, or any person claiming under or by virtue of any title granted them by the State of Washington and subject only to the exclusive jurisdiction of the United States.

It is further alleged that the State of Washington has granted certain rights to the defendants thereafter named as to certain tidelands described therein which border upon the Skokomish Indian Reservation, and alleges various specific defendants and their specific ownership which conflicts with the reserved rights of plaintiff. The complaint prays that the title to the tidelands bordering the Skokomish Indian Reservation be quieted in plaintiff, that defendants be forever barred and estopped from claiming any right or title in and to said lands, that the court grant necessary relief to remove said defendants from said lands and define the rights of plaintiff in and to said lands, and for such further and equitable relief as the court may deem proper.

The City of Tacoma, one of the named defendants, filed an answer herein on September 8, 1949 delineating its title and praying that plaintiff's complaint be dismissed and that defendant recover costs. This is the only answer filed herein on behalf of any of the specific defendants. Numerous of the defendants have filed motions to dismiss the action herein. The challenges to the complaint may be summarized as hereafter set forth.

Jurisdiction

Since this action involves the interpretation of an Indian Treaty and of an order of the President creating an Indian Reservation it would seem elementary that the district court of the United States has jurisdiction.

Objection is made to the amount in controversy on the ground that the actual value of the various holdings of the several defendants is in many instances less than \$3,000. However, what the plaintiff is seeking is to secure title to all the tidelands in front of or bordering on the Skokomish Indian Reservation. The value of such tidelands certainly exceeds \$3,000. Therefore the court would appear to have jurisdiction in the event that judgment is hereafter given for the plaintiff to put into effect the incidents of such judgment, such as removing specific defendants from their tidelands.

Plaintiff's Capacity to Sue

Plaintiff alleges that it is duly incorporated under an Act of Congress, naming the Act, and that all things necessary to be done have been done to entitle plaintiff to bring this action.

Action in the Superior Court of the State of Washington for Mason County

The defendant, Charles T. Wright, in his amended motion to dismiss, moves this court for a dismissal of this action or in lieu thereof a suspension of same on the ground that there is now pend-

ing a prior action (filed July 30, 1948) in the Superior Court of the State of Washington for Mason County. Copy of the state court complaint attached to such amended motion discloses that the action was brought by Charles T. Wright and that the Skokomish Indian Tribe is named as a party defendant. The issues raised in the complaint in the state court case are not identical with the issues raised herein and there is nothing in the file to show that plaintiff herein has filed an answer in the state court case raising the same issues as are raised herein. This court cannot presume that the issues in the Wright case will be the same. Therefore, there would appear to be no reason to justify this court's refusing jurisdiction in favor of the Wright case nor holding the action herein in abeyance until the completion of the state court case.

State of Washington

The State of Washington has moved to dismiss on the ground the court has no jurisdiction over it and has filed a brief in support of such position, claiming that it has not consented to this suit and that under the laws of this state an action to quiet title to any property in which the state is a necessary or proper party defendant may be commenced and prosecuted against the state "in the superior court of the county in which such real property is situated," which the state contends cannot be construed as waiving its immunity from suit in a federal court.

Plaintiff's complaint alleges the execution of the Indian Treaty on January 26, 1855 and of the Executive Order of President Grant on February 25, 1874. The State of Washington did not come into being until 1889. Under the second subdivision of Section 4 of the Enabling Act and Article 26 of the state constitution the state forever disclaimed "all right and title * * * to all lands lying within said limits owned or held by any Indian or Indian tribes * * *." Therefore, if plaintiff is to prevail it must prevail upon a title which antedated statehood by some fifteen years. Compare *Taylor v. United States*, 44 F. 2d 531, certiorari denied 283 U.S. 820, with *Moore v. United States*, 157 F. 2d 760, affirming 62 F. Supp. 660, certiorari denied 330 U.S. 827, to note the effect which statehood might have upon this question. Moreover, it is to be noted that in practically every case which has arisen within the limits of the State of Washington involving a claim by an Indian Tribe either to ancient fishing grounds or to the ownership of tidelands or the construction of such Treaties and Presidential orders as those involved herein, the State of Washington has been a party and no reported opinion can be found wherein the State of Washington has been dismissed upon the ground urged by the state herein. *United States v. O'Brien*, 170 Fed. 508, *United States v. Stotts*, 49 F. 2d 619.

Moreover, the state is a proper party defendant in an action involving "ancient fishing grounds" of Indians.

Laches

The general rule is that rights of Indians are not subject to the ordinary provisions of law either as to statutes of limitations or laches. *United States v. Moore*, *supra*. The decision herein is made upon motions to dismiss only. The record is completely silent as to any facts herein which might conceivably have a bearing upon the question of laches. The court cannot infer facts where none are pleaded. Irrespective of what the court's decision might be when all the facts are in the record it would appear that at the present time nothing in the record herein would warrant this court in overruling the long line of authorities to the effect that neither laches nor the statute of limitations run against Indians asserting alleged rights under facts comparable with those herein.

Therefore, the motions to dismiss of Fred Hanson, E. L. France, Trustee, Estate of E. S. Avey, Mabel V. Avey, Minnie E. Watson, W. H. France, Jane Doe France, E. L. France and Leo B. France, F. G. Chapman and Bertha A. Chapman, Marcus Nalley and Frances Nalley, husband and wife, Ernest Worl and Beulah Worl, his wife; John W. Phillips and Jean S. Phillips, his wife; Allen M. Strine; Walter Asen and Lorraine Asen, his wife; Ernest Carlson and Hulda S. Carlson, his wife; Seattle First National Bank of Shelton, Washington; George W. Willis and Grace F. Willis, his wife; Carl J. Macke and Florence Macke, his wife; George F. Wolf and Vivian A. Wolf, his wife;

Luella L. Greeley; and Daniel R. Doran and Florence Doran, his wife, State of Washington, Simpson Logging Company for itself and as the successor to the defendant, Phoenix Logging Company, and Frances C. Simpson, heir of George Simpson, deceased, Paul Hunter and Mary Hunter, husband and wife, and each of them, are hereby denied. The amended motion to dismiss of Charles T. Wright is likewise denied.

Dated this 16th day of July, 1952.

/s/ WILLIAM J. LINDBERG,
United States District Judge.

[Endorsed]: Filed July 29, 1952.

[Title of District Court and Cause.]

MOTION TO DISMISS FOR LACK OF PROSECUTION

Comes now, Chas. R. Lewis, attorney for Paul Hunter and Mary Hunter, husband and wife, and moves the Court to dismiss the above entitled action for failure of Plaintiff to prosecute diligently. Plaintiff relies on affidavit of Chas. R. Lewis, hereto attached for granting of this motion.

/s/ CHAS. R. LEWIS,
Attorney for Paul Hunter and Mary Hunter, husband and wife.

[Endorsed]: Filed February 10, 1954.

[Title of District Court and Cause.]

MOTION TO DISMISS

Comes now the defendant Charles T. Wright, by and through his attorneys of record herein, and moves the court to dismiss this action for failure of the plaintiff to prosecute the action herein.

This motion is based upon the records and files herein and the annexed affidavit.

J. W. GRAHAM,
B. FRANKLIN HEUSTON and
GLENN E. CORREA,

/s/ By GLENN E. CORREA,
Attorneys for Charles T. Wright.

United States of America,
Western District of Washington,
County of Mason—ss.

Glenn E. Correa, being first duly sworn, on oath deposes and says:

That he is one of the attorneys of record herein for the defendant, Charles T. Wright, and makes this affidavit in support of said defendant's motion to dismiss this action for failure of the plaintiff to prosecute this action in accordance with existing law and procedure, and in particular Rule 41(b) of the Federal Rules of Civil Procedure.

This action was commenced by service of Summons and Complaint, the same being under Civil Action No. 1183 in this court and dated December

20, 1948; that the defendant, Charles T. Wright, duly appeared in this action and on or about January 25, 1949, served upon the attorneys for plaintiff a motion to dismiss. That on or about February 19, 1949, the defendant, Charles T. Wright, served an amended motion upon the plaintiff's attorneys, Davis, Keith and Winston and Kenneth R. L. Simons, 1121 Paulsen Building, Spokane, Washington; that on or about February 19, 1949, defendant, Charles T. Wright, was notified by the Clerk of this Court that Judge Leavy had disqualified himself and had transferred this action to the Northern Division in Seattle for all purposes.

On October 30, 1950, this defendant received a Motion and Notice of Hearing on Motion to Add additional parties defendant by the plaintiff, such hearing being noted for the 13th day of November, 1950; or or about April 3, 1951, the attorneys for plaintiff notified Mr. Heuston, that defaults had been taken against almost all of the defendants and further indicating that the plaintiff was to pursue the action to a conclusion; after considerable delay, Judge William J. Lindberg entered an order dated July 16, 1952 denying motions to dismiss the complaint.

That on or about August 5, 1952, the defendant, Charles T. Wright, served and filed his answer herein. A pre-trial date of March 26, 1953 and trial date of April 1, 1953, was set by Judge Lindberg, but upon motion of W. E. Evenson, attorney for other defendants in this action, these dates were

set aside. Judge Lindberg then made and entered a Notice of Call Calendar for May 5, 1953, but this case was passed on that call calendar due to death of Kenneth R. L. Simmons, one of the attorneys for plaintiff, and the case setting of this action was reset for August 31, 1953. On July 7, 1953, a Notice of Call Calendar was made by for July 14, 1953, for the U. S. District Court, Western District of Washington, Southern Division at Tacoma, under cause No. 1183. The defendant, Charles T. Wright, appeared at that call calendar, by the undersigned attorney, along with other counsel for defendants; it appearing that the plaintiff or its counsel were not present at this call calendar, the matter was passed by the court.

This action has been pending for several years, as above set forth in detail, and the plaintiff has made little effort to get this case set for trial; the title to the defendants' property, as described in the complaint, has been clouded by virtue of this action, and unless the action is finally, promptly and completely adjudicated or dismissed, a hardship or inconvenience could and does exist by reason of the pendency of this action. That plaintiff has had ample and sufficient time to litigate this case and to have same set for trial, and any further continuance of this action would be contrary to rules of procedure of this court and is potentially prejudicial to the property rights of this moving defendant. This action should either be set for trial at an early and certain date or be dismissed in accordance with existing rules of procedure.

/s/ GLENN E. CORREA.

Subscribed and Sworn to before me this 6th day of February, 1954.

[Seal] /s/ B. FRANKLIN HEUSTON,
Notary Public in and for the State of Washington,
residing at Shelton.

[Endorsed]: Filed February 10, 1954.

[Title of District Court and Cause.]

MOTION TO DISMISS

The defendants, E. L. France, Trustee, Estate of E. S. Avey, Mabel V. Avey, Minnie E. Watson, W. H. France, Jane Doe France, E. L. France and Leo B. France, move the Court to dismiss the above entitled action for failure of the plaintiff to prosecute with due diligence.

/s/ JOHN L. MILLER,
Attorney for Above Named
Defendants.

[Endorsed]: Filed February 19, 1954.

[Title of District Court and Cause.]

MOTION

Come now the defendants E. L. France, Trustee, Wallace O. Hanson, Buster F. Hanson, Olympia F. Kern, Agnes Granger and Alice Hanson, and move

the court that the above action be dismissed on the following ground, to wit:

That the said action has not been prosecuted diligently.

That for 5 years or more the said action has constituted a cloud upon the title to the tide lands owned by the said defendants.

/s/ J. W. GRAHAM,

Attorney for said Defendants.

[Endorsed]: Filed February 19, 1954.

[Title of District Court and Cause.]

MOTION TO DISMISS

The defendant, City of Tacoma, respectfully moves the above-entitled Court to dismiss this action for failure of the plaintiff to prosecute its case with due diligence.

CLARENCE M. BOYLE,

DEAN BARLINE,

FRANK L. BANNON,

W. L. BROWN, JR.,

PAUL J. NOLAN,

ALLAN R. BILLET,

/s/ By W. L. BROWN, JR.,

Attorneys for City of Tacoma.

[Endorsed]: Filed February 19, 1954.

[Title of District Court and Cause.]

AFFIDAVIT IN SUPPORT OF
MOTION TO DISMISS

State of Washington,
County of Pierce—ss.

W. L. Brown, Jr., being first duly sworn, on oath deposes and says: that he is one of the attorneys of record in the above-entitled matter for the City of Tacoma, a municipal corporation, defendant; that on or about the 20th day of December, 1948, summons was issued in the above-entitled matter and the same was served on the defendant herein named on the 14th day of May, 1949, five months and 25 days from the date of issuance of said summons; that on or about the 17th day of May, 1949, appearance was made by said defendant and served on attorneys for the plaintiff and filed in this Court; that thereafter the plaintiff failed to diligently prosecute its cause of action, without fault of the defendant herein named; that this matter was set for April 1, 1953, but was continued, due to no fault of the defendant City of Tacoma, and that since that time the plaintiff has not been represented at the various calls of the calendar on which this matter was scheduled; further that the plaintiff has taken no steps to bring the matter to trial; affiant believes that this case should be dismissed for failure to prosecute.

/s/ W. L. BROWN, JR.

Subscribed and sworn to before me this 19th day of February, 1954.

[Seal] /s/ IRENE D. STRONG,
Notary Public in and for the State of Washington,
residing at Tacoma.

[Endorsed]: Filed February 19, 1954.

[Title of District Court and Cause.]

MOTION

Comes now defendant State of Washington and moves this Honorable Court that this action be dismissed as against the State of Washington, on the ground that this Court has no jurisdiction, the state not having consented to be sued or waived its immunity from suit.

In the event this motion is denied, without waiving the same, the State of Washington moves this action be dismissed for want of diligent prosecution.

/s/ DON EASTVOLD,
Attorney General,
/s/ E. P. DONNELLY,
Assistant Attorney General,
Attorneys for Defendant,
State of Washington.

[Endorsed]: Filed February 20, 1954.

[Title of District Court and Cause.]

**MOTION TO DISMISS FOR
WANT OF PROSECUTION**

Come now the defendants Ernest Carlson et al. by their undersigned attorneys and hereby join in all of the several pending motions to dismiss for want of prosecution made by other defendants herein.

**SKEEL, McKELVEY, HENKE,
EVENSON & UHLMANN,**

/s/ By **W. E. EVENSON,**
Attorneys for Defendants
Carlson et al.

Acknowledgment of Service Attached.

[Endorsed]: Filed February 23, 1954.

[Title of District Court and Cause.]

**ORDER DENYING MOTION TO DISMISS
AND SETTING FOR TRIAL AND PRE-
TRIAL CONFERENCE**

This matter having come on regularly for hearing before the Hon. George Boldt, Judge of the above entitled Court on February 23, 1954, at Tacoma, Washington, upon the February, 1954, Term Call Calendar and upon the motions of the appearing defendants, to dismiss the above entitled cause for failure of the plaintiff to prosecute the action, the plaintiff appearing by one of its attorneys,

P. H. Winston; the defendant, Charles T. Wright, appearing by one of his attorneys, Glenn E. Correa; the defendant, State of Washington, appearing by one of its attorneys, E. P. Donnelly; the defendants, E. L. France, Trustee, Wallace O. Hanson, Buster F. Hanson, Olympia F. Kern, Agnes Granger and Alice Hanson, appearing by their attorney, J. W. Graham (represented in court by Mr. Correa); the defendants, E. L. France, Trustee, Estate of E. S. Avey, Mabel V. Avey, Minnie E. Watson, W. H. France, Jane Doe France, E. L. France and Leo B. France, appearing by their attorney, John L. Miller (represented in Court by Mr. Correa); the defendants, Paul Hunter and Mary Hunter appearing by their attorney, Chas. R. Lewis, (represented in Court by Mr. Correa), the defendants, Ernest Carlson, Hulda S. Carlson, Walter Asen, Lorraine Asen, John W. Phillips, Jean S. Phillips, Ernest Worl, Beulah Worl, George W. Willis, Grace F. Willis, Allen M. Strine, Carl J. Macke, Florence Macke, Seattle First National Bank, Daniel R. Doran, Florence Doran, George F. Wolf, Vivian A. Wolf, Lucella L. Greely, Ralph Alexander and Adeline T. Alexander, being represented by one of their attorneys, W. E. Evenson, and the defendant, City of Tacoma, represented by one of its attorneys, W. L. Brown, Jr., the Court having first heard the argument of counsel in support of the motions to dismiss and having considered a trial date and pretrial conference date, and being in all respects fully advised in the premises, now, therefore it is

Ordered that each and all of the motions of the defendants for dismissal of the above entitled action for failure of the plaintiff to prosecute the same, be and they are hereby denied; and it is further

Ordered that the above entitled cause be, and it is hereby set for trial before this Court upon the merits to commence on the 20th day of July, 1954, at the hour of 10 o'clock a.m.; and it is further

Ordered that the above entitled cause be and it is hereby set for pretrial conference before this court on the 17th day of May, 1954, at the hour of 2 o'clock p.m.; and it is further

Ordered that if by fault of the plaintiff the above entitled cause is not ready to proceed to trial as set on the 20th day of July, 1954, the cause will then be dismissed for failure of the plaintiff to prosecute the action; and it is further

Ordered that upon the pretrial conference on the 17th day of May, 1954, the defendant, State of Washington, may renew its motion to dismiss the above entitled action as to such defendant on the ground that this Court has no jurisdiction in this action over the State of Washington.

Done in open Court this 20th day of April, 1954.

/s/ GEO. H. BOLDT,
Judge.

Presented by:

/s/ P. H. WINSTON,
Of Counsel for Plaintiff.

Approved and Notice of Presentment Waived:

/s/ (Illegible),

/s/ E. P. DONNELLY,

Assistant Attorney General.

[Endorsed]: Filed April 20, 1954.

[Title of District Court and Cause.]

STATEMENT OF DEFENDANT, STATE OF
WASHINGTON, AS TO ITS POSITION
ON JURISDICTION

Counsel for the State of Washington are advised that the pretrial order now being prepared will show that plaintiff intends to assert title to tidelands belonging to the sovereign State of Washington and, therefore, feel it their duty to suggest to the court in the words of the rule of Civil Procedure 12 (h) that since the sovereign State of Washington has consented to be sued only in the superior court of that county of the State of Washington in which the property is situated (RCW 4.92.010) this court, if it has jurisdiction as against defendants other than the State of Washington, has no jurisdiction as to the sovereign State of Washington.

One quotation from *Monaco v. Mississippi*, 292 U.S. 313, 329, should suffice to sum up this well settled principle:

“Protected by the same fundamental principle, the States, in the absence of consent, are immune

from suits brought against them by their own citizens or by federal corporations, although such suits are not within the explicit prohibitions of the Eleventh Amendment. *Hans v. Louisiana*, supra, (134 U.S. 1); *Smith v. Reeves*, supra, (178 U.S. 436); *Duhne v. New Jersey*, supra, (251 U.S. 311, 314); *Ex parte State of New York*, No. 1, supra, (256 U.S. 490, 498).” (Citations supplied.)

Where the sovereign state is not made a defendant in name the suit will be dismissed for lack of jurisdiction if it is actually a suit against the state.

Williams v. American Security and Trust Co., 91 F. Supp. 421. *Copper S. S. Co. v. State of Michigan*, 194 F. (2d) 465.

A motion to dismiss this case for want of jurisdiction as to the State of Washington was presented to and denied by Judge Lindberg and a similar motion is now contained in the state’s answer.

It is, nevertheless, proper under the cited rule of civil procedure to suggest lack of jurisdiction as the court is not required to wait until the trial of this case on the merits and the court is not bound by Judge Lindberg’s ruling.

In *Mills v. United Association of Journeymen, etc.*, 83 F. Supp. 240, the court held that jurisdiction over the subject matter of the controversy is never *res judicata*. One motion attacking the jurisdiction having been overruled, the propriety of the second motion was questioned, and the court said on page 244:

"At whatever stage in the proceedings a lack of jurisdiction is apparent to the court, at that time it is the duty of the court to consider and pass upon its jurisdiction. *Gayle v. Jones, et al.*, D.C., 63 F. Supp. 481; *Emmons v. Smitt, et al.*, D.C. 58 F. Supp. 869, certiorari denied, 326 U.S. 746, 66 S. Ct. 59, 90 L. Ed. 446. Jurisdiction over the subject matter of a controversy is never *res judicata*. The law is well stated in *Blossfield v. Pacific Tank & Pipe Co.*, D.C., 15 F. 2d 889, 890, where the court states in a case where a prior motion to dismiss for the lack of jurisdiction was overruled, and a subsequent motion on the same grounds was sustained:

" 'Plaintiff argues that the earlier ruling has become the law of the case, and that it therefore may not be set aside. Were not the jurisdiction of the court in question, this must have been conceded. * * * It would be not only an extraordinary but a useless thing to permit the trial of a case which, on the allegations of the complaint, must be dismissed for want of jurisdiction at the close of the plaintiff's case; which, if not then dismissed, must be dismissed, on the court's own motion * * * at any time before the entry of a final decree at which the lack of jurisdiction was suggested; and which, on appeal, would be dismissed, rather than reviewed, because of lack of jurisdiction.'

"So, in the light of the aforementioned opinions, the plaintiff's contention that the subject of jurisdiction has been once determined and is now conclusive, is without merit, and must be denied."

When the state's original motion was presented to Judge Lindberg it was necessarily presented on the plaintiff's complaint. Paragraphs XII and XIII of this complaint apparently state a cause of action against defendants other than the State of Washington in that they affirmatively allege that “* * * the rights of the defendants and any person claiming by, through, or under them should be forever barred and declared to be invalid and without any legal effect by any grant from the state of Washington.” (Emphasis supplied.)

Moreover, the motion was argued orally to Judge Lindberg at least partially as a fishing right case. The pre-trial order now in the course of preparation will contain a claim of title to tidelands which have not been disposed of by the state, part of which the state is using for its own purposes, and all of which have been uniformly and continually in the possession and ownership of the State of Washington in its sovereign capacity.

The pleadings on the filing of the pre-trial order will pass out of the case so that the question of the court's jurisdiction of an action in which it is sought to deprive the state of tidelands which it is subjecting to its own use will be squarely presented to the court.

While the Attorney General is not authorized to confer jurisdiction if there is none (*Title Guaranty and Surety Company v. Guernsey*, 205 Fed. 94, cited in *MacVeigh v. Unemployment Comp.*, 19 Wn. (2d) at page 389), and while the question of jurisdiction may be raised at any time even on

appeal, orderly procedure and common courtesy require that the matter be called to the attention of the trial court at the earliest opportunity.

O'Connor v. Slaker, 22 F. (2d) 147, is a case wherein one of the counts plaintiff sought to quiet title against any claim of a sovereign state. It was, of course, held that the court was without jurisdiction to do this. The position of the Attorney General in O'Connor v. Slaker gave the court considerable trouble. Counsel for the state in the case at bar, therefore, desire at the earliest opportunity to suggest to the court that this is now a case against the state, and that if the court has jurisdiction of this case against any defendants other than the State of Washington, it does not have jurisdiction against the sovereign state, because that state has not waived its immunity from suit other than in a state court. The state has always been allowed to intervene in actions brought against its grantees in this jurisdiction without waiving its sovereign immunity and without causing the court to lose jurisdiction, if any, of the case against the state's individual grantees. The state has never been sued in this or any other jurisdiction.

In one of the earliest cases, U. S. v. Ashton, 170 F. 509, Judge Cushman pointed out that the state intervened in an action brought against its grantees to acquire title to tidelands “* * * merely to preserve its sovereignty.”

U. S. v. McGowan, 2 F. Supp. 426, in reality involves two cases affecting the title to tidelands. In one of them the state was allowed to intervene in

the aid of its grantee and so in the second case the state was made a nominal party defendant but no affirmative relief was asked against the state. Judge Cushman said:

“* * * No statute of the state of Washington has been called to the court’s attention authorizing a suit such as the present against the state to be brought in a District Court of the United States. An examination of the bill of complaint, however, shows that no affirmative relief is asked against the state of Washington, although it is prayed that the court confirm the treaty rights of the Quinaielt and Quillehute Indians, including the individual plaintiffs above named as members of the former tribe, in and to the use and enjoyment, as a usual and customary fishing ground upon the tidelands described in the bill without license or lease from the state of Washington. This court may consider the rights and powers of the state in determining issues asserted by the United States against the individual and corporate defendants, claiming under rights acquired from the state, although it may not undertake to determine and enforce such rights against the state itself or its officers.” (Emphasis supplied.)

The U. S. District Court for Oregon in the exercise of its discretion refused even to allow the states of Washington and Oregon to intervene in a similar case and approved the underlined portion of Judge Cushman’s language just quoted. *U. S. v. Columbia River Packers Assn.*, 11 F. Supp. 675,

680. (Citing *Minnesota v. Hitchcock*, 185 U.S. 373, to the effect that the supreme court has exclusive jurisdiction over all controversies of a civil nature [title to real property] where the state is a party.)

As this court pointed out in *United States of America, plaintiff, v. State of Washington, et al., defendants, and Louise Napoleon Johns, et al., cross-defendants*, Civil No. 1529 in the United States District Court for the Western District of Washington, Southern Division, all the issues in a case involving title to tidelands may be directly and expeditiously tried in the proper superior court of the State of Washington under the authority contained in RCW 4.92.010 and without any question of jurisdiction being involved.

It is proper to consider this fact where the jurisdiction is questionable. *Williams v. Virginia Military Institute*, 198 F. (2d) 980.

The State of Washington respectfully submits, however, that this court will not either grant or attempt to enforce any judgment against the sovereign State of Washington. We trust the court will not consider the suggestion of lack of jurisdiction as being prematurely made.

Respectfully submitted,

/s/ DON EASTVOLD,

Attorney General,

/s/ E. P. DONNELLY,

Assistant Attorney General.

[Endorsed]: Filed March 16, 1955.

City of Tacoma
Washington
Office of City Attorney

October 5, 1955

Miss Edith E. Redmayne
Deputy U. S. District Court Clerk
Federal Building
Tacoma, Washington

In re Cause 1183 — Skokomish Indian Tribe v.
France, Trustee, et al.

Dear Miss Redmayne:

In answer to your notice concerning the above case, I would like to point out that although the matter may be technically at issue and ready for trial, Judge Boldt on April 18, 1955, signed an order to the effect that the cause would not be heard for trial until a pretrial order had been signed. That order placed the burden on the plaintiff to initiate a conference with the attorneys for the defendants so that a pretrial order might be prepared for presenting to the Court. To date no communication has been received by this office concerning any conference with the plaintiff and therefore I do not think the order of the Court has been complied with and the matter is not yet ready for assignment for trial. For this reason I think the matter should be stricken from the trial setting on December 1, 1955. I trust that this will answer your letter.

In the event that you determine the matter is not to be on the trial calendar on December 1, would

you be kind enough to notify this office as well as the other counsel involved in this cause.

Yours very truly,

/s/ W. L. BROWN, JR.,
Asst. City Attorney.

WLB:k

[Stamped]: Received October 6, 1955.

[Title of District Court and Cause.]

MOTION TO DISMISS PLAINTIFF'S ACTION
FOR FAILURE OF PLAINTIFF
TO PROSECUTE ITS ACTION

Comes now the City of Tacoma, one of the defendants in the above-entitled action and moves the above-entitled Court to dismiss the plaintiff's action, on the grounds that the plaintiff has failed to prosecute its action within the time allowed by law.

Dated this 6th day of July, 1956.

MARSHALL McCORMICK,
City Attorney,

/s/ By W. L. BROWN, JR.,
Assistant City Attorney.

Acknowledgment of Service Attached.

[Endorsed]: Filed July 23, 1956.

[Title of District Court and Cause.]

AFFIDAVIT OF W. L. BROWN, JR., ASS'T
CITY ATTORNEY, IN SUPPORT OF
DEFENDANTS' MOTION TO DISMISS
PLAINTIFF'S ACTION FOR FAILURE
OF PLAINTIFF TO PROSECUTE

State of Washington,
County of Pierce—ss.

W. L. Brown, Jr., being first duly sworn, on oath deposes and says: that he represents the defendant, City of Tacoma, in the above-entitled action and that he makes this affidavit in support of defendants' Motion to Dismiss Plaintiff's Cause of Action for Want of Prosecution. This case was filed December 3, 1948, and was served on the City of Tacoma on May 5, 1949. That thereafter there have been several motions argued in this matter and the case had been set for trial April 1, 1953. This setting was vacated at the request of one of defendants' counsel and was again placed on the Assignment Calendar May 5, 1953. It was again on the Assignment Calendar August 31, 1953. Defendants then filed a Motion to Dismiss the Plaintiff's cause of action for want of prosecution. Thereafter the Court signed an Order April 20, 1954, denying said Motion but provided that if the plaintiff did not proceed to trial as set on the 20th day of July, 1954, the cause would then be dismissed for failure of the plaintiff to prosecute the action.

This trial date was vacated and a final trial date

of April 25, 1955, was given all parties. In conjunction therewith the Court also set several pretrial conferences. The pretrial conferences were held and the defendants had prepared a proposed pretrial order. Thereafter the plaintiff and defendants met on April 14, 1955, for a preparation of a final pretrial order to be presented to the Judge prior to the trial scheduled for April 25, 1955. Plaintiff's counsel, Mr. Lyle Keith, was present and the pretrial conference was adjourned by all parties until the following day, at which time the conference was to be held at the office of Mr. Wm. Evenson in Seattle. Mr. Keith promised to attend. On the following day, April 15, 1955, your affiant was present in Mr. Evenson's office and Mr. Keith did not appear. A telephone call was made to his hotel but we were advised Mr. Keith had checked out. Thereafter Mr. Evenson called the Court and informed the Court that no pretrial order was ready for the Court's consideration. The Court therefore indicated he would vacate the April 25, 1955 trial date. All attorneys were notified of this action by letters sent out to all counsel. This letter was dated April 15, 1955. That letter also informed all counsel that if they had any objections to call your affiant by April 18, 1955, otherwise your affiant would advise Judge Boldt in open Court of the situation. No calls were received by your affiant and on April 18, 1955, your affiant appeared in open Court and informed Judge Boldt of the situation. At that time Judge Boldt struck the matter from the trial date of April 25, 1955, and in an oral order from the

bench provided that no trial date would be set until a pretrial order had been signed.

Thereafter there was correspondence between all parties as to a new trial date. However, no action has been taken by the plaintiff, either by way of requesting a date for a pretrial conference or requesting that the matter be set for trial by the Court. Fourteen months have elapsed since said trial date.

/s/ W. L. BROWN, JR.

Subscribed and sworn to before me this 6th day of July, 1956.

/s/ IRENE D. STRONG,

Notary Public in and for the State of Washington,
residing at Tacoma.

Acknowledgment of Service Attached.

[Endorsed]: Filed July 23, 1956.

[Title of District Court and Cause.]

REASONS AND BRIEF OF AUTHORITIES
IN SUPPORT OF DEFENDANTS' MO-
TION TO DISMISS PLAINTIFF'S AC-
TION FOR FAILURE OF PLAINTIFF
TO PROSECUTE ITS ACTION

All of said defendants, with the exception of the State of Washington, join in this motion to dismiss plaintiff's action, in accordance with the Federal Rules of Civil Procedure, Rule 41 (b), and the local rules of Civil Procedure of the United States District Court for the Western District of Washington, Rule No. 41.

The State of Washington does not join herein

because the State has made a continuing objection as to the jurisdiction of the above-entitled Court over the State of Washington in this action.

This action was served on defendant, City of Tacoma, on May 14, 1949, and filed December 3, 1948. Since that time the matter has been set a number of times for trial. The last time this matter was set for trial by the Honorable George H. Boldt, was for the 25th day of April, 1955. At the time it was set for trial on this date, the Judge also set the matter for a number of pretrial conferences. These pretrial conferences were held but no final pretrial order was agreed upon and Judge Boldt, on April 18, 1955, entered an order to the effect that the matter would not be set for trial until the pretrial order had been signed and presented to the Court. By this order, the Judge placed a burden on the plaintiff to present a pretrial order and have the matter set for trial.

Since that time, no action has been taken by the plaintiff, although fourteen months have elapsed since this order was entered by the Judge.

This defendant and all other defendants, excluding the State of Washington, feel that this is a proper case for a dismissal for failure of plaintiff to prosecute its action in the manner required by the Federal Rules of Civil Procedure, as well as the local Rules of Civil Procedure.

The power of the Court in this respect is set forth clearly in Barron and Holtzoff, Federal Practice and Procedure, Rules Edition, Volume 2, Sections 917 and 918. Such a motion, of course, is ad-

dressed to the Court's sound judicial discretion.

Where the plaintiff has failed to prosecute its action with reasonable diligence, the Court may dismiss the action on defendants' motion or on its own motion. What is reasonable diligence differs with each case. In the case of *Shotkin v. Westinghouse Electric & Manufacturing Company*, C.A. 10th, 1948, 169 F. 2d, 825, the Court held that where a plaintiff in August, 1943, instituted an action for injunctive relief and damages under the Sherman Anti-Trust Act and from time to time plaintiff filed numerous groundless motions and engaged in tactics indicating a studied purpose to drag case along without trial, and on March 11, 1947, the Court entered order reciting that case would be dismissed for failure to prosecute unless cause to the contrary was shown before May 6, and no substantial affirmative showing was made by plaintiff as to why case should not be dismissed, dismissal of case on May 16, 1947, was not an abuse of discretion.

It has also been held in *Hicks v. Bekins Moving & Storage Co.*, C.A. 9th, 1940, 115 F. 2d, 406, that the dismissal by the Federal District Court in Washington of its own motion in an action for injuries sustained from alleged conspiracy in violation of Sherman Anti-Trust Act, was not an abuse of discretion where cause had been called sixteen times during period of over twenty months before being set for dismissal and present counsel had been corresponding with original counsel relative to assuming duties of attorney for plaintiff for period of almost eight months, during which time the for-

mer attorney was having case "watched" without disclosure to the Court. This case also held that the defendants were not required to show specific impairment of their defense in order to justify Court to dismiss its own motion, since the law will presume injury from unreasonable delay. This case further held that an order of dismissal for want of prosecution may be granted, notwithstanding the plaintiff has been stirred into action by impending dismissal, since subsequent diligence is no excuse for past negligence.

The Courts have held that a delay of sixteen months is unreasonable in the case of *United States v. Bernstein*, C.C.A. 5th, 1948, 116 F. 2d, 466. The Courts have also held that a delay of two years was unreasonable in the case of *Tinkoff v. Jarecki*, C.A. 7th, 1953, 208 F. 2d, 861. It has also been held that a delay of two or three years is unreasonable in the case of *United States v. Pacific Fruit & Produce Co.*, C. A. 9th, 1943, 138 F. 2d, 367. It has likewise been held that a cause pending for more than six years was unreasonable. *Refior v. Lansing Drop Forge Company*, C.C.A. 6th, 1942, 124 F. 2d, 440, it has also been held that where, after filing suit, no action was taken in it by plaintiff for one year and three months, action was properly dismissed for want of prosecution. *Salmon v. City of Stuart, Florida*, C. A. 5th, 1952, 194 F. 2d, 1004. See also *Livingston v. Hobby*, D.C.P.A. 1954, 127 F. Supp. 463, and *Timmons v. United States*, C.A. 4th, 1952, 194 F. 2d 357.

The defendants likewise feel that this action

should be dismissed by the Court with prejudice. Such a dismissal is within the discretion of the Court and is provided for in the Federal Civil Rules of Procedure, Rule 41 (b). Such a right also is recognized and has been applied in *Hicks v. Bekins Moving & Storage Co.*, cited above, and Section 917 *Barron & Holtzoff* as above cited.

Defendants likewise point out to the Court that a Motion to Dismiss this same cause for want of prosecution by plaintiff, was heard at a prior time and the motion was denied. However, the Order Denying the Motion to Dismiss signed April 20, 1954, provided in part that if plaintiff was not ready to proceed to trial as set on the 20th day of July, 1954, the cause will then be dismissed for failure of the plaintiff to prosecute the action. That trial date was eventually changed at the instance of Mr. Evenson, representing some of the defendants, to April 25, 1955. However, the plaintiff was not ready for trial on April 25, 1955, even though defendants had drafted a proposed pretrial order. The plaintiff has again not shown diligence in getting this matter disposed of and defendants feel within their rights by asking the Court to dismiss plaintiff's cause with prejudice.

Dated this 6th day of July, 1956.

MARSHALL McCORMICK,
City Attorney,

/s/ By W. L. BROWN, JR.,
Assistant City Attorney.

Acknowledgment of Service Attached.

[Endorsed]: Filed July 23, 1956.

[Title of District Court and Cause.]

PRETRIAL ORDER

Pretrial conferences having been had herein, plaintiff being represented by its attorneys of record herein, Keith, Winston & Repsold, by Lyle Keith and P. H. Winston, and the several defendants by their respective attorneys of record herein, the Court determines that the parties have settled upon the terms of this order, as follows:

Admitted Facts

For the purposes of this action, it is by the parties hereto agreed that the following matters may be accepted by the Court as true, without the necessity of further proof thereof:

I.

That plaintiff is incorporated under the Act of Congress of June 18, 1934 (48 Stat. 984), as amended by the Act of June 15, 1935 (49 Stat. 378).

II.

A treaty between the United States of America and certain Indian tribes was made January 26, 1855, the full text of which is Exhibit 1 herewith, and appears in full in 12 Stat. L., at pages 933 to 937, inclusive, and was proclaimed April 29, 1859.

III.

Article II of said treaty is as follows:

“Article II. There is, however, reserved for the present use and occupation of the said tribes and

bands the following tract of land, viz.: the amount of six sections, or three thousand eight hundred and forty acres, situated at the head of Hood's Canal, to be hereafter set apart, and so far as necessary surveyed and marked out for their exclusive use; nor shall any white man be permitted to reside upon the same without permission of the said tribes and bands, and of the superintendent or agent; but, if necessary for the public convenience, roads may be run through the said reservation, the Indians being compensated for any damage thereby done them. It is, however, understood that should the President of the United States hereafter see fit to place upon the said reservation any other friendly tribe or band, to occupy the same in common with those above mentioned, he shall be at liberty to do so."

IV.

On February 25, 1874, the following Executive Order was issued:

"Executive Mansion,
February 25, 1874.

"It is hereby ordered that there be withdrawn from sale or other disposition and set apart for the use of the S'Klallam Indians the following tract of country on Hood's Canal in Washington Territory, inclusive of the six sections situated at the head of Hood's Canal, reserved by treaty with said Indians January 26, 1855, (Stats. at Large, Vol. 12, p. 934), described and bounded as follows: Beginning at the mouth of the Skokomish River; thence up

said river to a point intersected by the section line between sections 15 and 16 of township 21 north, in range 4 west; thence north on said line to a corner common to sections 27, 28, 33 and 34 of township 22 north, range 4 west; thence due east to the southwest corner of the southeast quarter of the southeast quarter of section 27, the same being the southwest corner of A. D. Fisher's claim; thence with said claim north to the northwest corner of the northeast quarter of the southeast quarter of said section 27; thence east to the section line between sections 26 and 27; thence north on said line to corner common to sections 22, 23, 26 and 27; thence east to Hood's Canal; thence southerly and easterly along said Hood's Canal to the place of beginning.

U. S. GRANT."

* * * * *

Plaintiff's Contentions

Plaintiff, without the concurrence therein of defendants, makes the following contentions:

I.

That the Skokomish Indian Reservation includes tidelands on the Hood's Canal and the Skokomish River abutting the original boundaries of said Skokomish Indian Reservation.

II.

That the uplands, together with the shorelands in Hood's Canal, became and were reserved to the exclusive use, benefit, and occupancy of the Skoko-

mish Indian Tribe, together with the exclusive right for the use of the bed of Hood's Canal and all tidelands touching upon or bordering the reservation, and with the exclusive right as guaranteed by Article IV of the treaty of January 26, 1855, to fish in all the waters bordering upon the reservation as set out by said executive order, including the tidal waters which border upon and touch the reservation.

III.

That the exclusive right of fishing was to be free from interference from the State of Washington or any person or persons claiming under or by virtue of any title granted them by the State of Washington and subject only to the exclusive jurisdiction of the United States.

IV.

That any rights claimed by the State of Washington or of any person or persons claiming through or under the State of Washington with respect to such tidelands are in conflict with and in derogation of the reserved rights of the plaintiff.

V.

That the rights of the plaintiff herein are paramount and superior to any right or to any title of whatsoever nature claimed by the defendants.

VI.

That the title and/or right of the plaintiff, the Skokomish Indian Tribe, in and to the tidelands as hereinabove described, should be quieted in said

plaintiff and that the claimed rights of the State of Washington and the other defendants and any persons claiming through or under them should be forever barred and declared to be invalid and without any legal effect.

VII.

That the plaintiff and its members have an exclusive right to fish and take shell fish as it and they desire upon any and all such tidelands herein described adjacent to the Skokomish Indian Reservation and that in any event the defendant State of Washington and any and all of the defendants cannot exclude the Skokomish Indian Tribe and the individual members thereof from fishing and taking shell fish from such tidelands and all thereof when and as they may desire.

VIII.

That the jurisdiction of this Court arises in this matter for the reason that plaintiff is an Indian Tribe incorporated under the Acts of Congress, and the rights demanded to be protected arise out of an Indian treaty entered into between said Indian Tribe and the United States, and the matter in controversy exceeds, exclusive of interest and costs, the sum of Three Thousand Dollars.

IX.

That it was the intent and purpose of the United States of America and the tribes of Indians executing said treaty of January 26, 1855, to encourage said tribes of Indians to reside at one place on a reservation to be set aside for their use and occu-

pancy, which was done by the Executive Order of President Grant, dated February 25, 1874. That the tracts of land so selected were to be sufficient for their wants as they then existed and continued to exist in the future.

X.

That by reason of the tidal waters flowing and ebbing in the Hood's Canal there are certain lands bordering upon the reservation of the Skokomish Indian Tride as hereinabove described, which provide an excellent and profitable source of shell fish having use for human consumption and a high commercial value.

XI.

That the State of Washington cannot claim immunity from suit in Federal Court in this action which relates to rights of plaintiff vested prior to statehood, which rights the State of Washington was required to respect and observe as a condition precedent to admission to statehood.

XII.

That all matters and things alleged and asserted by the defendants do not constitute a defense to the action.

XIII.

That the plaintiff Tribe has never conveyed or agreed to convey its rights asserted herein to the State of Washington or any of the other defendants in this action.

XIV.

That the tidelands constituting a portion of the

reservation were not appurtenant to or a part of any individual allotment made to any individual Indian upon said reservation and did not pass to any individual Indian under the allotment or under any conveyance of said property comprising any allotment, whether said conveyance was made by the United States or by the individual allottee.

Defendants' Contentions

Defendants, without the concurrence therein of plaintiff, make the following contentions:

1. Defendants deny the claims of plaintiff asserted in its complaint.

2. Plaintiff's claims and allegations do not state a cause of action or a basis upon which any relief can be granted herein.

3. The tide lands and tidal waters flowing and ebbing in and upon Hood Canal and the tide lands and tidal waters bordering upon the Reservation of the Skokomish Indian Tribe were never and are not now used commercially or extensively or at all by the plaintiff or its component or alleged members, trustees, agents or its predecessors in interest for fishing or otherwise, except that the Skokomish River which lies adjacent to and within the Reservation has been and is used for fishing purposes.

4. The only rights the plaintiff or its component members have in hunting and fishing outside the boundaries of the Skokomish Indian Reservation, if any, is a privilege to hunt and fish in common with other citizens and not a right to title to specific tide lands or tidal waters.

5. The land and the legal descriptions of land contained and mentioned in the Treaty and Executive Order and in the surveyor's notes and surveys and in Bureau and departmental correspondence and records do not contain, mention or include tide lands or tidal waters, and nothing therein grants, gives or conveys or reflects an intention to grant, give or convey to plaintiff or to any predecessor of plaintiff any right, title or interest in or to any land not therein described nor to any tide lands or properties which are now claimed by defendants.

6. The survey of public lands in the vicinity of Hood's Canal was not completed until the year 1873.

7. The survey of the exterior boundaries of the Skokomish Indian Reservation in the Territory of Washington described the same in part as follows:

"* * * Begin at a stake * * * on left bank of Skokomish River, thence north on west boundary * * * Set a post for corner to Sections 9, 10, 15 and 16 * * * East on north boundary and south line of A. D. Fisher's donation claim * * * Set post on west side of Hood's Canal and on the south boundary of A. D. Fisher's donation claim * * * Thence with the meander of Hood's Canal * * * To meander post on Township line of 21 and 22 North Range 4 West. Thence with the meanders of Hood's Canal and the Skokomish River to the place of beginning * * *"

See Exhibit

8. The reservation pursuant to said treaty, at the

time of the completion of the survey of the area by the Surveyor General, contemplated a north margin for said reservation south of the section line between Section 26 and Section 35, Township 22 North, Range 4 East, established by such survey. See Exhibit

9. The remaining northerly portion of said Section 35 and all land in said Section 26, Township 22 North, Range 4 West, abutting on Hood's Canal, was at the time of said survey in an area known as the A. D. Fisher Donation Claim. See Exhibit

10. One A. D. Fisher had proved up on said area, known as the A. D. Fisher Donation Claim and prior to the completion of said survey was entitled to a patent, which, however, could not issue until the completion of said survey, and he was entitled to said patent upon the completion of said survey.

11. As related in Exhibit, the United States Indian Agent for Washington Territory, the Superintendent of Indian Affairs, the Commissioner of Indian Affairs, the Secretary of the Interior, proposed an Executive Order enlarging the then reservation to include the A. D. Fisher Donation Claim and the enactment by the Congress of legislation to compensate A. D. Fisher for the taking of said land and for his improvements.

12. The appropriation to compensate said A. D. Fisher for the taking of said lands and improvements was enacted and the heirs of said A. D. Fisher were paid for such lands and improvements.

13. The Skokomish Indian Reservation was di-

vided into Indian lots by a deputy surveyor, acting under the Surveyor General, at the request of the Indian Agent, per Exhibit

Indian Lots Nos. 2 and 3 in Section 26, Township 22 North, Range 4 West, were each subdivided into Tract 1 and Tract 2, respectively, per Exhibit

Tract 1 of Indian Lot 3 in said Section 26, Township 22 North, Range 4 West, was then further subdivided into Tracts 1-A and 1-B, per Exhibit

14. The portion of said tide lands in Section 26, Township 22 North, Range 4 West, (abutting on said A. D. Fisher Donation Claim) was held in trust for the State of Washington to be formed, as abutting upon lands which in effect had passed from the public domain and passed to private ownership under the Act of September 27, 1850, and which donation claim the United States reacquired for the extension of said Indian Reservation by purchase from A. D. Fisher.

15. The State of Washington, to the extent that it is a predecessor in title to any of these defendants, obtained title to the tide lands below the line of ordinary high tide of Hood Canal by virtue of the laws of the United States and the provisions of the Enabling Act providing for the formation of the government of the State of Washington and its admission into the Union and the provisions of the Constitution of the State of Washington, accepted by the United States as in conformity with the laws of the United States and the provisions of said Enabling Act. The State of Washington thereby had and asserted its ownership of the beds and

shores of all navigable waters in the State up to and including the line of ordinary high tide, in waters where the tide ebbs and flows, except lands patented prior to statehood. Plaintiff and its predecessors never had and cannot now assert any interest, title, or right to tide lands of the defendants or any of the properties of defendants. Said Constitution of the State of Washington so providing was accepted and ratified as conformable to the laws of the United States. The admission of the State of Washington into the Union was proclaimed by the President of the United States on November 11, 1889.

16. Insofar as the tide lands are or could be considered a part of said Reservation, the same were and are a part of the allotted lands conveyed and patented under the allotments and patents referred to in the Admitted Facts portion of this order.

17. That at the time of acquisition of said tide lands from the State of Washington by defendants and their predecessors, said tide lands were vacant and unoccupied.

18. Plaintiff has not instituted this action nor asserted its claims within the time limited by law.

19. During all of the time since each of the several grants, conveyances and patents referred to in the Admitted Facts portion hereof or in the Defendants' Contentions portion hereof and for more than ten (10) years each grantee, condemnor, or contract purchaser has been in the actual, continuous, exclusive, open, notorious, and obvious possession, enjoyment and occupancy of the related up-

lands and adjoining tide lands and all portions thereof.

20. The defendants and their predecessors in interest, respectively, have occupied, used and claimed said properties under color of title and claim of right for more than seven years prior to the institution of this action and have paid all taxes thereon levied and accrued for more than seven (7) years prior to the institution of this action.

21. If plaintiff was incorporated, as by plaintiff alleged, and has capacity to sue, as by plaintiff alleged, the same occurred more than ten (10) years prior to the commencement of this action the defendants and their predecessors in interest have been in the actual, exclusive, open, notorious and obvious possession, enjoyment and occupancy of all of the several properties in which the defendants are interested, as herein pleaded, and have openly and obviously cleared, cultivated, improved, built upon and developed said properties at great cost and expense, and during all such period have paid the taxes thereon.

22. The plaintiff, its predecessors in interest, its component members and agents have failed to assert any claim, title or rights to the tide lands involved up to the time of the commencement of this action notwithstanding the several defendants and their predecessors in interest since the time of the several patents, allotments, conveyances, judgments and grants herein referred to, have openly and obviously cleared, cultivated, improved, built upon and

developed said properties at great cost and expense. Any taking by plaintiff of any of said properties or parts thereof would unjustly deprive defendants of their said efforts, the betterments, and the investment of the defendants therein, and would unjustly enrich the plaintiff. Plaintiff is estopped and barred to claim or assert any title, interest or right in or to any part of the properties claimed by the defendants respectively.

23. The United States government by treaties and executive orders set aside for the use and occupation of certain Indians a tract of land bordering on the Skokomish River. The Indians were accustomed to taking fish from the waters of and on the shore bordering on the Skokomish River. Thereafter the State of Washington, claiming ownership to the tide lands bordering Hood Canal, sold said tide land to individuals who, in reliance on the State's claim of ownership, purchased these lands and made many and costly improvements thereon. Said Indians for many years past have been and are now intelligent and educated persons who have been fully aware of the claims of the State of Washington to the tide lands in question and of their sale by the State. Approximately seventy-five years after the United States government had set aside this Reservation to the Indians and after the defendants herein had purchased these tide lands and made improvements thereon and had increased the value of said lands, the plaintiff laid claim and asserted rights in these tide lands. The plaintiff has acquiesced, both by silence and conduct, for an

unreasonable period of time in the assertion of this claim and is now either estopped from asserting these alleged rights or barred by laches from claiming title to these lands.

24. There is a defect of parties plaintiff herein.

25. The court is without jurisdiction of the sovereign State of Washington, it not having consented to be sued in this court nor waived its immunity from suit.

26. The sovereign State of Washington retains mineral rights in many, if not all, of the tracts in controversy herein which it has sold under the laws of the State of Washington; retains title to certain others, certain of which it has, in the exercise of its sovereignty, occupied and still occupies for governmental purposes, such as highways and game preserves; and such use is necessary for the preservation of the government.

In reference to the several parcels referred to in Admitted Fact V and the paragraphs thereof, the State of Washington asserts the following claims of ownership or interest:

Paragraph 1—State owns all mineral rights.

Paragraphs 2 to 12, inclusive—State owns all the mineral rights in tide lands lying below mean low tide.

Paragraphs 13 to 17, inclusive—State owns all mineral rights.

Paragraph 18—State owns mineral rights in tide lands lying below line of mean low tide.

Paragraph 19—State owns all mineral rights in the entire oyster tract and also owns the rever-

sionary interest in the tract itself except that portion of the tract in front of Government Lots 1 and 2, Section 35.

Paragraph 20—State owns an easement for state highway over a portion of these tidelands.

Paragraph 21—State owns all mineral rights.

Paragraph 22—State owns this tract, James J. Smith having no interest therein.

Paragraph 23—State owns this tract.

Paragraph 24—State owns the reversionary right in this tract and owns all mineral rights.

Paragraph 25—State owns this tract.

Paragraph 26—State owns all mineral rights in this tract.

Paragraph 27—State owns all mineral rights in this tract.

Paragraph 28—State owns the tide lands in front of Indian Lots 1 and 2, Section 6, Township 21 North, Range 3 West.

Paragraph 29—State owns these tide lands.

Paragraph 30—Subdivision A—State owns the mineral rights in this property for which the City has an easement.

Paragraph 30—Subdivision B—State owns the fee subject to the City's easement.

Paragraph 31—State owns these tide lands subject to easement of the City of Tacoma.

Paragraph 32—State owns these tide lands used by State Game Department under provisions of Chapter 190, Laws of 1941.

27. In eminent domain proceedings prosecuted in the Superior Court of the State of Washington

for Mason County, Proceeding No. 1651, entitled "City of Tacoma, a municipal corporation, Plaintiff, vs. George H. Funk, et al., Defendants," and pursuant to due and lawful proceedings had and conducted therein, such right, title and interest of plaintiff and of plaintiff's predecessors in interest to the portions of the properties involved in this action which are embraced within the right of way of the transmission line of the City of Tacoma and its other installations and facilities of its municipal power plant were duly adjudicated and acquired.

28. A prior action to quiet the title to part of the lands which are the subject matter of this action, among other things, has been previously instituted by defendant Charles T. Wright in the case of Charles T. Wright, Plaintiff, vs. Paul Hunter, et ux., et al., Defendants, instituted in the Superior Court of the State of Washington for Mason County (filed July 30, 1948), under Case No. 5189. The Superior Court of the State of Washington for Mason County has prior and exclusive jurisdiction of the subject matter of this action, so far as said defendant is concerned, and of the parties thereto. The plaintiff herein is named as a party defendant in said Superior Court action and by reason of its failure and refusal to appear, answer or plead in said action an order of default has heretofore been entered against this plaintiff in said action. The Superior Court action is an action to quiet title, in which plaintiff could have raised by answer the issues set out herein,

and this controversy is subject to the determination, ruling and judgment of said Superior Court of the State of Washington.

29. This action has raised a dispute as to the location of the boundaries of the Skokomish Indian Reservation between plaintiff and some of the parties hereto and it may be necessary for the court to appoint a master or commission of land surveyors or engineers to survey some of the boundaries of said Reservation for the purpose of determining the location thereof.

30. The court is without jurisdiction of this action and of the defendants or any of them. The value in controversy, exclusive of interest and costs, does not amount to \$3000 as to any one of the defendants or his marital community.

Issues of Fact As Claimed By Plaintiff

I.

Whether it was the intent of the tribes executing the treaty of January 26, 1855, and the representatives of the United States Government negotiating said treaty on behalf of the United States Government to set aside for the exclusive use and benefit of the plaintiff tidelands bordering upon or adjacent to the reservation.

II.

Whether the effect of the presidential executive order of February 25, 1874, was to set aside to the plaintiff tidelands bordering upon or adjacent to the uplands reserved for the plaintiff by said executive order.

III.

Whether it was the intent of the tribes negotiating the treaty and the representatives of the United States Government to secure to the plaintiff an exclusive right of fishing on tidelands or waters bordering upon or adjacent to the uplands set aside and reserved for the plaintiff by the executive order of February 25, 1874.

IV.

Whether historically the Skokomish Indian Tribe and the tribes and bands which were settled on the Skokomish Indian Reservation were Indians whose needs and wants were served by fishing and gathering of shell fish in the tide waters of Hood's Canal and of the Skokomish River and whether Plaintiff has a paramount right to the use and occupancy of such tidelands for fishing and taking of shell fish and whether this right is paramount to all rights of all of the defendants to the tidelands herein described.

Issues of Fact As Claimed By Defendants

1. What is meant by the mouth of the Skokomish River, as stated in the Treaty, and where is it located?
2. Whether plaintiff has a superior title to the "tide lands" occupied and claimed by the State of Washington and by the several defendants.
3. Whether plaintiff, or anyone with whom plaintiff has a connected record title, ever had title to the "tide lands" claimed by defendants.

4. Whether the "tide lands" were a part of the Skokomish Indian Reservation.

5. Whether portions of the Reservation were lawfully allotted to individual Indians and title thereto vested in said individual Indians, their heirs and successors.

6. Whether the portions of the Reservation thus allotted to the Indians and the title thus vested in individual Indians or their heirs and successors included said "tide lands".

7. Whether defendants for more than ten years prior to the institution of this action have been in actual, open and notorious possession of the property claimed by plaintiff.

8. Whether defendants for more than seven years prior to the institution of this action have, under claim of right or color of title thereto, been in actual, open, notorious and adverse use and possession of the property in question and have paid taxes thereon for such time.

9. Whether defendants, under claim of right, to the knowledge of plaintiff, for more than seven years prior to the institution of this action, have exclusively occupied and held possession of said tide lands to the extent that they are capable of occupancy and possession, and whether the defendants respectively have cultivated, improved, reclaimed, developed and used the tide lands and, in the course thereof, expended moneys, time and effort and made valuable, tangible improvements thereon and upon tracts of land of which said tide lands are an integral part.

10. Whether the Skokomish Indians are or ever were dependent upon any food or fish from the several tide land properties in question and whether they have ever taken any food or fish from said tide land areas commercially or in appreciable quantities or at all.

11. Whether the benefits of the Reservation contemplated by the Treaty and the Executive Order were for the S'Klallam Indians and Indians other than the Skokomish Indians.

12. Whether the S'Klallam Indians, referred to in the Executive Order of February 25, 1874, are a tribe separate from and not the same as the Skokomish Indians.

13. Is the value in controversy (exclusive of interest and costs) as to each separate defendant \$3000.00 or more?

14. Whether any tidelands or tidal waters were ever mentioned, included or intended to be included in any surveyor's notes, surveys, correspondence or other departmental or Bureau record or in the Treaty or the Executive Order.

Issues of Law As Claimed By Plaintiff

I.

Where a quasi-political body cedes all of its right, title and interest to a body of land and waters bordering upon or adjacent to said land to a sovereign state in return for a conveyance back from the sovereign state of a smaller portion of said previously ceded lands and where such smaller portions of land border on and are adjacent to tidal and

navigable waters, does the conveyance back include exclusive title to the tidelands and shorelands bordering the navigable waters.

II.

Can the State of Washington, which came into existence after treaty rights were granted to the plaintiff herein, divest the plaintiff of those rights where one of the conditions upon which the State of Washington was admitted to the Union was that it disclaim any right, interest, or jurisdiction in and over rights previously vested in Indians or Indian tribes, and where the State of Washington has in law, but not in fact, disclaimed.

Issues of Law As Claimed By Defendants

1. Does the court have jurisdiction in this action of the State of Washington?
2. Does the court have jurisdiction in this action over the subject matter of this action and any of the defendants?
3. Does plaintiff have title to the properties which it claims in this action and, if so, from what source?
4. Does the plaintiff have any right entitling it to maintain this action and, if so, from what source and by virtue of what right?
5. Are the necessary parties for the maintenance of this action now parties to this proceeding?
6. Is the United States of America a necessary party to this action?
7. Are the S'Klallam Indians and other Indians

and tribes and bands of Indians and representatives thereof necessary parties to this action?

8. What is meant by "along Hood's Canal", as used in the Executive Order?

9. Is plaintiff corporation a grantee of or successor to all the interest beneficially provided for by the Treaty and Executive Order?

10. Did the State of Washington acquire title to the tide lands upon its admission into the Union?

11. Were the tide lands a part of the Skokomish Indian Reservation?

12. Were the tide lands in Section 26, Township 22 North, Range 4 West, at the location of the A. D. Fisher Donation Claim, a part of the Skokomish Indian Reservation?

13. Did A. D. Fisher or the State of Washington to be formed in Washington Territory have a right to the tide lands in Section 26, Township 22 North, Range 4 West, prior to the Executive Order of February 25, 1874, and in reliance upon the Act of September 27, 1850, antedating the said Treaty of January 26, 1855?

14. Were the tide lands a part of the related allotments to individual Indians and did the conveyances from the individual Indians to the present defendants or their predecessors in title include the related tide lands?

15. Is any right in plaintiff to maintain this action barred by limitation of law?

16. Have the defendants, as against the plaintiff, established a right to the properties in question by adverse possession?

17. Is plaintiff barred by laches to maintain this action or to obtain any relief herein?

18. Is plaintiff estopped to maintain this action and by estoppel precluded from the right to any relief herein?

19. Have the uses and development of the property by the defendants, the conduct of the plaintiff and of any predecessors in interest of plaintiff, been such as to create a situation where there would be an unjust enrichment of the plaintiff, if relief as prayed by plaintiff should be granted herein, and accordingly is the plaintiff precluded from any right to relief herein?

20. Is the value in controversy (exclusive of interest and costs) as to each separate defendant \$3,000.00 or more?

21. Does the Superior Court of the State of Washington for the County of Mason, in Proceeding No. 5189, entitled "Charles T. Wright, Plaintiff, v. Paul Hunter, et al., Defendants", have prior and exclusive jurisdiction of the subject matter of this action, at least so far as certain of the defendants herein are concerned who are also parties to said action in said Superior Court?

22. Is the plaintiff barred from the right to relief herein by reason of the proceedings had and the determinations made in said proceeding in the Superior Court of the State of Washington for Mason County, No. 5189, aforesaid?

23. Are the rights of the plaintiff or of its component members in hunting and fishing outside the boundaries of the Skokomish Indian Reservation;

if any, a privilege to hunt and fish in common with other citizens and not a right to title to specific tide lands or tidal waters?

24. Is this an action in which a dispute exists as to the location of boundaries, by reason of which it is necessary for the appointment of a master and/or commission of land surveyors or engineers to be made?

25. Did the City of Tacoma, a municipal corporation, defendant herein, as to the transmission line right of way by it claimed, acquire title thereto in part in the exercise of lawful eminent domain proceedings, barring thereby any further claim thereto by plaintiff?

26. Does the sovereign State of Washington retain mineral rights in the several tracts of land in controversy herein, under the enactments of the legislature of said State of Washington?

27. Does said defendant State of Washington, in the exercise of its sovereignty, occupy and have the right, for governmental purposes, to have and occupy highways and game preserves in the lands and areas claimed by plaintiff?

28. Are the defendants the legal owners of the several parcels of tidelands in issue by virtue of said tidelands having been vacant and unoccupied at the time of acquisition by the defendants and their predecessors respectively from the State of Washington and the further fact that defendants and their predecessors had color of title made in good faith to said lands and have paid all taxes

legally assessed thereon for seven consecutive years prior to the commencement of this action?

29. Is the condemnation action entitled *City of Tacoma vs. George H. Funk, et al.*, No. 1651, in the Superior Court of Mason County, Washington, *res adjudicata* as to the rights of the plaintiff in the property over which the City of Tacoma condemned a transmission line easement through said proceedings?

30. Do the patents issued by the United States to the various Indians on the Skokomish Indian Reservation prior to admission of the State of Washington to the Union, give such patentee title out to the government meander line?

31. Is this a collateral attack on a patent issued by the United States of America and one that cannot be maintained without the United States of America as a party thereto?

32. What is meant by the word "appurtenances" contained in the patents of the various Indian allottees in connection with the patents issued to them by the United States of America?

33. In any event, do the patents from the U.S.A. to individual Indians in which they were allotted certain property carry title to the low water mark?

34. Does the use made by the City of Tacoma of the tidelands in which the City of Tacoma is here involved, in any way interfere with the use of such tidelands by the plaintiff as set forth in that treaty referred to in Paragraph II of the Admitted Facts?

35. That at the time of acquisition of tidelands

from the State of Washington by defendants and their predecessors, said tidelands were vacant and unoccupied.

36. What rights are given to the plaintiff by reason of the treaty as referred to in Paragraph II of the Admitted Facts, in relation to the present claim of the plaintiff?

Exhibits

The exhibits of all the parties below listed were produced and marked and may be received in evidence, if otherwise admissible, without further authentication, it being admitted that each is what it purports to be, the right being hereby expressly reserved to object to the competency, relevancy or materiality thereof. Exhibits not listed will be admitted by the court where good cause is shown for the withholding or delay in presentation thereof.

Plaintiff's Exhibits

1. Copy of Corporate Charter of the Skokomish Indian Tribe.
2. Copy of the Constitution and By-Laws of the Skokomish Indian Tribe.
3. Copy of treaty entered into between the United States of America and the Skokomish Indian Tribe on January 26, 1855, 12 Stats. 933.
4. Copy of Executive Order dated February 25, 1874, setting aside the Skokomish Indian Reservation.
5. Photostatic copies of Government survey notes

delineating meander lines Skokomish Reservation (17 pages).

6. Photostatic copy of map of Skokomish Indian Reservation showing subdivisional lines and meanders, dated December 2, 1873.

7. Photostatic copy of map of Skokomish Indian Reservation as per Executive Order dated the 25th day of February, 1874, dated the 24th day of April, 1874.

8. Index map of Anna's Bay, dated June 7, 1952.

9. Copy of the resolution of authority passed by the Tribal Council of the Skokomish Tribe authorizing plaintiff's attorneys of record herein to institute and prosecute this action.

10. Minutes of proceedings leading up to the Treaty of Point-No-Point, January 25 and 26, 1855.

11. Letter from Governor Stevens to Mr. Manny-penny W537/1855.

12. Letter of February 21, 1874; Mr. Delano to Mr. Smith, National Archives, Report Book No. 24, page 125.

13. Letter of July 9, 1856, from Mr. Manny-penny to Mr. McClelland, National Archives, Report Book No. 9, page 359.

14. Instructions to Governor Stevens contained in letter dated August 30, 1854, from Charles E. Mix, Acting Commissioner of Indian Affairs.

15. Plat of Potlatch Tracts, Mason County, Washington.

Tideland Deed from State of Washington to Potlatch Commercial & Terminal Company dated

March 31, 1908—page 358, Volume 8, State Record of Tide Land Deeds.

Tideland Deed from State of Washington to Potlatch Commercial & Terminal Company dated June 6, 1911—Page 507, Volume 11, State Record of Tide Land Deeds.

Tideland Deed from State of Washington to J. T. Thacker, Millard Lemon and A. J. Falknor, dated June 6, 1911—Page 405, Volume 11, State Record.

Tideland Deed from State of Washington to Millard Lemon, J. T. Thacker and Lola F. Falknor, dated March 21, 1912—Page 353, Volume 11, State Record.

Tideland Deed No. 5790 from State of Washington to Potlatch Commercial and Terminal Company dated February 20, 1909—Page 62, Volume 9, State Record.

Tideland Deed from State of Washington to A. J. Falknor dated March 26, 1906—Page 320, Volume 7, State Record.

Tideland Deed from State of Washington to Homer Thacker, Lola Falknor and Jessie M. Hopkins dated March 26, 1906—Page 322, Volume 7, State Record.

Tideland Deed from State of Washington to Kimball Sherwood (Deed No. 10240), dated August 4, 1915—Page 28, Volume 13, State Record.

Tideland Deed No. 11929 from State of Washington to E. L. France dated October 22, 1918—Page 498, Volume 13, State Record.

Tideland Deed No. 14297 from State of Washing-

ton to F. G. Chapman dated April 22, 1925—Page 311, Volume 15, State Record.

Tideland Deed No. 14631 from State of Washington to Fred Hanson dated September 3, 1926—Page 504, Volume 15, State Record.

Tideland Deed No. 15568 from State of Washington to Fred Hanson dated May 7, 1929—Page 433, Volume 16, State Record.

Tideland Deed No. 15178 from State of Washington to E. A. Sims dated March 26, 1928—Page 125, Volume 16, State Record.

Tideland Deed No. 15168 from State of Washington to Frank A. Robison dated March 20, 1928—Page 119, Volume 16, State Record of Tide Land Deeds.

Tideland Deed No. 16050 from State of Washington to A. J. Falknor, Mrs. J. T. Thacker and Millard Lemon dated January 14, 1931—Page 66, Volume 17, State Record.

Tideland Deed No. 17179 from State of Washington to Casco Company and A. J. Falknor dated March 3, 1938—Page 253, Volume 18, State Record.

Tideland Deed No. 19390 from State of Washington to State Game Department dated October 11, 1946—Page 225, Volume 20, State Record.

Copy of order dated June 17, 1931, granting City of Tacoma right of way for transmission line over tide lands in Mason County—Filed in Office of Commissioner of Public Lands and a copy filed with Application No. 11328.

Photostatic copy of right of way plat submitted

by City of Tacoma to accompany Application No. 11328 for easement for right of way.

Copy of Order of June 14, 1921, granting City of Tacoma right of way—Copy filed with Application No. 11328, in office of Commissioner of Public Lands.

Topographic Survey T-1560-b by U. S. Coast and Geodetic Survey made in 1884.

Mason County Tideland Index Map No. 36.

Official map of Township 22 North, Range 4 West, W.M., approved July 26, 1873.

Official map of Township 21 N., Range 3 W., W.M., approved March 10, 1858.

Mason County Tideland Index Map No. 35.

Official map of Township 21 N., Range 4 W., W.M., approved November 23, 1861.

Mason County Tideland Index Map No. 37.

Plat of detached tide lands in Section 6, Township 21 N., Range 3 W., W.M.

State Road Plat No. 322 across Section 35, Township 22 N., R. 4 W., W.M.

Official map of Skokomish Indian Reservation in Township 21 North, Range 3 and 4 West, and Township 22 North, Range 4 West, W.M., approved November 28, 1884.

State survey in Section 35, Township 22 N. R. 4 W., W.M.

Defendants' Exhibits

1. Photostatic copy of publication entitled "Executive Orders relating to Indian Reservations from May 14, 1855, to July 1, 1912", printed by the

Government Printing Office in 1912, pages

2. Deeds and conveyances in the chains of title of the several defendants.

3. Photographs of Defendants' properties at various dates.

4. Plans, sketches and drawings showing improvement of defendants' properties and location thereof with reference to high water line and other boundaries.

5. Judgment roll in eminent domain proceedings, Mason County No., entitled "City of Tacoma, a Municipal Corporation, Plaintiff, vs."

6. Certified copy of record of proceedings in Superior Court of the State of Washington for Mason County, Case No. 5189, entitled "Charles T. Wright, Plaintiff, v. Paul Hunter, et al., Defendants".

7. Chart of Tribe relationships appearing on page 241 of Publication entitled "Contributions to North American Ethnology", Volume 1, Government Printing Office, 1877, at page 241.

8. Other historical documents or publications.

9. Field notes of Township 22 North, Range 4 West, W.M., so far as they relate to Section 26 therein.

10. Survey of Township 22 North, Range 4 West, W.M., per Surveyor General, July 26, 1873.

11. Map of Skokomish Indian Reservation showing numbered lots into which lands are divided by intermediate posts set by deputy surveyor at request of Indian Agent, conformable to field notes

on file in office of Surveyor General per certificate of May 19, 1885.

12. Supplemental diagram of Section 26, Township 22 North, Range 4 West, W.M., showing subdivision of Lots 2 and 3.

13. Supplemental plat of Section 26, Township 22 North, Range 4 West, W.M., showing subdivision of Tract 1, Block 3.

14. Documents concerning A. D. Fisher Donation Claim, furnished by the National Archives, consisting of:

i. December 8, 1873, letter from Marshall Blinn, Acting Superintendent of Indian Affairs, W. T., to Hon. E. P. Smith, Commissioner of Indian Affairs, Washington, D. C., with attached exhibits "A" to "F" inclusive.

Document "A"—Copy of appraiser's report to Superintendent of Indian Affairs.

Document "B"—Field notes of survey by A. C. Smith, deputy surveyor, certified by Surveyor General, showing exterior boundaries of Skokomish Indian Reservation in Territory of Washington.

Document "C"—Plat of the original Reservation marked yellow and the proposed change marked red, with the blue line designating the A. D. Fisher Claim.

Document "D"—Report of Edwin Eells, Indian Agent at Skokomish.

Document "E"—The certificate of final proof of A. D. Fisher Donation Claim, with the definite location by J. T. Brown, Register of the U. S. Land Office, Olympia, W. T.

Document "F"—Copy of letter dated February 3, 1866, from Superintendent W. H. Waterman to the Honorable Commissioner.

ii. February 28, 1874, letter from the Secretary of the Department of the Interior to the Speaker of the House of Representatives, transmitting draft of bill for relief of A. D. Fisher.

iii. Draft of bill for relief of A. D. Fisher.

iv. February 21, 1874, letter from E. P. Smith, Commissioner of the office of Indian Affairs, to the Honorable O. B. McFadden, of the House of Representatives, proposing description for Executive Order and proposing bill for the relief of A. D. Fisher.

15. A certified copy of Judgment in the Condemnation case City of Tacoma vs. George H. Funk, et al., No. 1651.

16. A certified copy of the file of the Bureau of Indian Affairs relating to the above condemnation.

17. Certified copy of receipt in said condemnation case signed by the Indian Agent and official representative of the Bureau of Indian Affairs.

18. Certified copy of patent from U.S.A. to Charles Cush.

19. Certified copy of deed from Charles Cush to H. N. Woolfield.

20. Certified copy of patent from U.S.A. to Charles Frank.

21. Certified copy of patent from U.S.A. to Ellen M. Rudy.

22. Certified copy of patent from U.S.A. to Mamie Wilbur.

23. Original file of George Adams, et al., vs. City of Tacoma, No. 428, in the Clerk's Office of the District Court of the United States for the Western District of Washington, Southern Division.

24. Map of original Skokomish Indian Reservation allotments showing names and numbers of individual allottees.

25. Certified copy of patent from U.S.A. to Joe Dan.

26. Certified copy of deed from Joe Dan to H. Woolfield.

27. Certified copy of patent from U.S.A. to Tyee Dick.

28. Certified copy of deed from Tyee Dick to H. N. Woolfield.

29. Certified copy of patent from U.S.A. to H. N. Woolfield.

30. Certified copy of patent from U.S.A. to Old Shell.

31. Certified copy of patent from U.S.A. to Old Hee Hee.

32. Certified copy of patent from U.S.A. to Wilson Waterman.

33. Certified copy of patent from U.S.A. to Samson.

34. Certified copy of patent from U.S.A. to Big Bill.

35. Certified copy of patent from U.S.A. to James Wilbur Haitwas.

36. Certified copy of survey of government meander lines bordering Skokomish Indian Reservation.

37. Certified copy of survey of Indian allotments on the Skokomish Indian Reservation.

38. Photostatic copy showing properties in which the City of Tacoma has an interest which are subjects of this law suit.

39. Certified copy of Judgment in City of Tacoma vs. Ellen M. Rudy, No. 1863.

40. Photographs of the Cushman No. 2 powerhouse bordering Hood's Canal.

41. Certified copies of patents to McKinney Pulsifer, Joseph Pulsifer, John Hawk, Squaxon George, Henry R. Allen, Sore Eyed Bill, American Machinery Association, Phoebe Moses and James Pulsifer.

42. Treaties of other Indian tribes in the State of Washington.

43. Photographs showing transmission line and towers at points involved in this action.

44. Certified copy of Judgment in Henry R. Allen, et al., vs. City of Tacoma, No. 2567, Mason County.

45. Photostatic copy of Noncompetent Indian Lands Deed, from Thomas Pulsifer, as Grantor, to E. L. France, Grantee, executed February 8, 1918.

46. Photostatic copy of deed, from State of Washington, as grantor, to E. L. France, as Grantee, to second class tide lands abutting upon north half of Tract 2, Lot 3, Section 26, Township 22

North, Range 4 West, W.M., Mason County, Washington, executed October 22, 1918.

Defendant State of Washington, at all times continuing its objection to any jurisdiction of this court over the sovereign State of Washington, by participating in the entry of this pretrial order, conferences therefor, or in approving this order, does not thereby consent to such jurisdiction nor join in any contentions expressed by any of the defendants for affirmative relief, such as for the designation of a commission of land surveyors or any other relief whatsoever.

No recital in or provision of this order shall in any case have any bearing upon nor affect the right, title and interest of any defendant as to any property or right as against any other defendant hereto, and this order and all proceedings leading up to this order shall be without prejudice as between the defendants respectively.

The foregoing Pretrial Order has been approved by the parties hereto, as evidenced by the signatures of their counsel hereon, and this order is hereby entered, as a result of which the pleadings pass out of the case, and this Pretrial Order shall not be amended except by order of the court pursuant to agreement of the parties or to prevent manifest injustice.

Entered at Tacoma, Washington, this 1st day of October, 1956.

/s/ GEO. H. BOLDT,

United States District Judge.

Form Approved:

Keith, Winston & Repsold, By Lyle Keith, Attorneys for Plaintiff.

Ryan, Askren & Mathewson, By Raymond P. Swanson, Attorneys for Defendants Simpson Logging Company and Frances Simpson.

Henderson, Carnahan, Thompson & Gordon, By Harry Sager, Attorneys for Defendants Marcus Nalley, et ux.

Glenn E. Correa, Attorney for Chas. T. Wright.

J. W. Graham, Attorney for E. L. France—Chas. T. Wright.

B. Franklin Heuston, Attorney for Chas. T. Wright.
Subject to right to prove claim of title.

Don Eastvold, Attorney General, By E. P. Donnelly, Attorney for State of Washington.

Robert R. Hamilton, City Attorney, City of Tacoma.

Charles R. Lewis, Attorney for Paul Hunter and Mary Hunter. Subject to right to introduce evidence of title.

Skeel, McKelvy, Henke, Evenson & Uhlmann, By W. E. Evenson, Attorneys for Defendants Carl J. Macke, et al.

[Endorsed]: Filed October 1, 1956.

[Title of District Court and Cause.]

TRANSCRIPT OF COURT'S ORAL DECISION

rendered in the above-entitled and numbered cause in the above-entitled Court before the Honorable George H. Boldt, United States District Judge, on Wednesday, June 12, 1957, at the United States Courthouse, Tacoma, Washington.

Appearances: On behalf of the Plaintiff: Keith, Winston & Repsold, Attorneys at Law, Paulsen Building, Spokane, Washington. On behalf of Defendant Simpson Logging Company: Mr. Raymond P. Swanson, Ryan, Askren & Mathewson, Attorneys at Law, Henry Building, Seattle, Washington. On behalf of Defendant Marcus Nalley, et ux: Mr. Harry Sager, Henderson, Carnahan, Thompson, & Gordon, Attorneys at Law, Puget Sound Bank Bldg., Tacoma, Washington. On behalf of the Defendant State of Washington: Mr. E. P. Donnelly, Asst. Attorney General, Temple of Justice, Olympia, Washington. On behalf of the Defendants Carl J. Macke, et al.: Mr. W. E. Evenson, Skeel, McKelvy, Henke, Evenson & Uhlmann, Attorneys at Law, Dexter Horton Bldg., Seattle, Washington. On behalf of the Defendant City of Tacoma: Mr. Robert R. Hamilton, Tacoma City Attorney, Tacoma City Hall, Tacoma, Washington. On behalf of the Defendants Paul Hunter and May Hunter: Mr. Charles R. Lewis, Attorney at Law, Shelton, Washington. On behalf of the Defendants E. L. France and Charles T.

Wright: Mr. J. W. Graham, Attorney at Law, Shelton, Washington. On behalf of the Defendant Charles T. Wright: Mr. Glen E. Correa, Attorney at Law, Shelton, Washington. Mr. B. Franklin Hueston, Attorney at Law, Shelton, Washington.

The Court: That seems to conclude the points listed in Mr. Keith's memorandum with respect of jurisdiction.

On this last point concerning amount in controversy, I may say that I am not persuaded that the contention is well taken and have little difficulty in reaching the conclusion that the jurisdictional amount is sufficiently alleged and stated in both the complaint and the pretrial order.

An extremely interesting presentation of these points has been submitted. My compliments to counsel on a splendid presentation. Notoriously, jurisdictional questions in the Federal Courts often are difficult of solution. Primarily this is because of the difficulties inherent in our system of dual sovereignty. You do not need or want any further dissertation from me on so philosophical a matter as that.

In further reflection on my remarks earlier this morning in the argument, it has occurred to me that a solution of this matter not suggested by any counsel, may perhaps be the true answer to our problem. This case has been pending over eight years. It involves three thick files.

Unfortunately, prior to the argument I was not as familiar with the contents of those files as I

now am. I still am not fully familiar with all that has gone on before in this protracted litigation.

I now have examined Judge Lindberg's opinion, and it is quite clear the points now urged and suggested were not presented to Judge Lindberg. As a matter of fact, at the time Judge Lindberg wrote his opinion the United States wasn't in the case. It had been dismissed out previously, and I gather because it was supposed that only interests of Bonneville Power Administration were involved. When the complaint was prepared, apparently the United States was named as a party defendant with "Bonneville Power Administration" named in brackets on the theory that somehow or other Bonneville was concerned with the controversy. Apparently when the Justice Department or the Bonneville Power Administration concluded that they weren't interested they came in and asked that the United States be dismissed out of the case, and Judge Bowen signed an order dismissing the United States, reciting it was not a necessary party, without any opposition or without any question being raised. Obviously, all that was suggested to Judge Bowen at that time was simply that Bonneville had no interest in the case and, therefore, the United States might properly be let out. Thus it appears that none of my brethren have been given an opportunity to pass on the questions that you now raise, and, frankly, it would seem that some of you have not thought until recently about these serious jurisdictional questions.

So much by way of alibi for myself in not fully perceiving the situation presented on the jurisdictional questions before.

Regardless of the past, we must now consider the matter as it presently appears. On the first point raised relating to consent to suit by the State, I am still of the opinion, indicated earlier this morning; namely, that it is extremely doubtful whether there was or has been a consent by the State to be sued, particularly as far as the notice of appearance constituting a consent to suit or waiver of immunity from suit, whichever way you want to put it. It seems very doubtful to me that that will ever be so held in view of the philosophy of the Ford case wherein the Supreme Court announced that a state's immunity is absolute, and the Court will not strain itself to find waivers by interpretation. I am not entirely sure the first phase of that point based on RCW 79.08.020 is well taken. I think in considering whether that section gives the Attorney General the authority to consent, you must also consider the other section, 4.92.010 which specifically deals with jurisdiction. If you read the two sections together it may be seriously questioned whether the Attorney General is authorized to waive immunity from suit unless the Legislature has specifically set forth the class of cases in which he may do so, or something to that effect. But, gentlemen, after further thought about it, I do not think this the point we have for decision.

In view of the Candelaria case, I do not see how

it can be questioned that the Indians have juristic capacity. Candelairea says in so many words, and apparently there is no later authority to indicate the contrary. Now, if the tribe or individuals of the tribe have the capacity to sue, and the United States is a necessary party to the suit, it seems to me the Indians have a right to join the United States as a party plaintiff, whether the United States wants to be a plaintiff or not, somewhat similar to the procedure under the Miller Act. Some of you probably are acquainted with Miller Act procedure where private litigants are authorized to name the United States as party plaintiff even though the United States has no direct interest in the litigation. In Miller Act cases the statute expressly so provides. Incidentally, that statute may possibly be applicable to a situation of this kind. That has not been explored as fully as might be.

Rule 19 says: "(a) When a person who should join as a plaintiff refuses to do so, he may be made a defendant, or in proper cases, an involuntary plaintiff." I think the United States as trustee for these Indians of lands wherein the fee is in the United States, should have been made a plaintiff in this action along with the Indians. The trustee should have been a plaintiff, and I think that the court, *sui sponte*, can direct it under Rule 19(a). If so, in an equity proceeding, at least, the old maxim ought to apply, that the Court will deem that done which ought to have been done, and in such case treat the case as

though the United States had been a plaintiff as of the commencement of the action. If that had been or can be deemed so, then, of course, the situation would fall squarely within the Oil and Gas case, United States vs. State of Washington, 233 Federal 2d, 811. Such solution would dispose of all of these contentions.

It is not for me to concern myself with the problems facing counsel in the ordinary situation, but here we have a case long pending in this court involving substantial interests of a lot of people, including the United States, the State, and others, and I am inclined to think that even at this late time I should consider requiring the United States to be made a party, and then upon its being made a party treat the case as though the United States were a party from the beginning and thus consider the case to fall within 28 U.S.C. 1345, which would confer jurisdiction on the court, both of the subject matter and of the person of the State of Washington.

Because this is a new and convenient idea, and therefore, perhaps, suspect, even in my own mind, and because none of you has had a chance to think about it, I believe the proper thing to do would be to direct that the United States be given notice that the court intends to consider making the United States a party plaintiff, and to treat that as having been done as of the commencement of the action, and to set the matter down for hearing when the United States can be heard on the subject, and all of you can be heard after consideration of

the suggestions that I have indicated in the last few minutes. Is my thought clear to all of you? I realize that my thought may not be well expressed because of its being newly acquired, but do you all understand what I have in mind?

In brief, it is this: The juristic capacity of the Indians to sue clearly appears, I think, from *Candelaria* and other cases; if they had the capacity to sue and it was necessary for the United States to be a party in such a suit, the United States should have been named as a plaintiff in the first place; the United States could have been named as a plaintiff in the first place because it is trustee for the Indians and holds the fee in some of the lands in question. If it had been so, the rule stated in *United States vs. State of Washington*, 233 Federal 2d, 811, would apply. In an equitable proceeding, or even an action at law, should not the action be deemed one commenced by the United States when it ought to have been commenced by the United States?

That in brief are my thoughts about it. Now, if that position is sound, it disposes of the "indispensable party" argument and it disposes of the "other action pending" argument. Perhaps it does not dispose of the amount in controversy, but as to that I am in no doubt. In any event, if we have jurisdiction under 28 U.S.C. 1345, the amount in controversy is not a jurisdictional requisite. It looks to me as though this may be the proper solution of the matter, but in order not to deal hastily with a matter that has apparently not seemed espe-

cially urgent to counsel during the last eight and a half years, I think I had ought to give you an opportunity to digest these thoughts and to point out wherein they are in error, as well as to hear from the United States before requiring them to be made a party.

I think, Mr. Driscoll, you will have to take such action to notify the United States as you deem proper. If you think it more appropriate I will issue a show cause order in formal fashion requiring the United States to appear and show cause why it should not be made a party. On the other hand, if it turns out the Justice Department is willing to come in and respond to my proposal without formality, that will be satisfactory to me if it is to you.

Now, I would like to get on with this very speedily because of the long pendency of this action.

Certificate

I, Gerald J. Popelka, Official Court Reporter for the within-entitled court, do hereby certify that the foregoing is a full and complete transcript of matters therein.

/s/ GERALD J. POPELKA.

[Endorsed]: Filed July 25, 1957.

[Title of District Court and Cause.]

MOTION

The plaintiff, Skokomish Indian Tribe, by and through its attorneys of record, Keith, Winston & Repsold, hereby respectfully moves the Court to enter an order herein directing that the United States of America be joined as an additional party plaintiff herein and that the plaintiff, Skokomish Indian Tribe, be permitted to amend its complaint in the following particulars:

I.

That the caption of the above entitled cause be amended to read in part as follows: "The Skokomish Indian Tribe and the United States of America, plaintiffs, vs. E. L. France, Trustee, * * *", without any change as to the listed defendants.

II.

That a new sentence be added to Paragraph I of the complaint, said new sentence to read as follows: "That the United States of America holds the fee title in and to the lands hereinafter described, in trust, however, for the use and occupancy of the plaintiff, Skokomish Indian Tribe, and has a real and present interest therein, and said Tribe is entitled to the aid and protection of the United States of America to prevent the unlawful disposition of said lands."

III.

That Paragraph 1 of the prayer of said com-

plaint be amended to read as follows: "That this Court quiet title of said plaintiffs in and to the above described lands, the same to be held, administered and disposed of by the United States of America, conformably with the laws pertaining thereto, and for the use and benefit of the plaintiff, Skokomish Indian Tribe, and that the defendants herein be forever barred and estopped from claiming any right or title in and to said lands."

This motion is based upon the files and records herein and for the reason that the United States of America should be made a party plaintiff in order to accord full and complete relief between those already parties herein and for the reason that the United States stands in the position of holding fee title in the property mentioned in the complaint, in trust for the use and benefit of the plaintiff, Skokomish Indian Tribe, and is a real party in interest herein.

KEITH, WINSTON & REPSOLD,
/s/ By LYLE KEITH,
Attorneys for Plaintiff, Skokomish
Indian Tribe.

[Endorsed]: Filed July 31, 1957.

[Title of District Court and Cause.]

MEMORANDUM

Comes now Charles P. Moriarty, United States Attorney for the Western District of Washington,

and Charles W. Billinghamurst, Assistant United States Attorney, acting by direction of the Attorney General of the United States in special appearance and without in any manner submitting the United States of America to the jurisdiction of the Court, to object to plaintiff's motion that the United States of America be joined as a party plaintiff in this cause of action for the reason that the Court has no jurisdiction over the Government in this cause, as more fully appears below.

I.

The United States of America is immune from the processes of all courts except in those specific instances concerning which Congress has waived immunity and consented that the Government and its instrumentalities may be sued or otherwise made party to litigation. We know of no Congressional waiver of immunity empowering the Court to join the United States as a party plaintiff to this cause of action.

II.

Moreover, the Attorney General of the United States has objected to such joinder. In 5 U.S.C. 309, et seq., Congress has delegated to the Attorney General the authority to initiate litigation on behalf of the United States. As the head of the Department of Justice, one of the major executive branches of the Government, the Attorney General alone has the responsibility and the right to determine when and in what manner the Government should assert its litigative rights.

New York v. New Jersey, 256 U.S. 296, 307-308; Booth v. Fletcher, 69 App. D.C. 351, 354; 101 F. 2d 676, cert. den. 307 U.S. 628; Castell v. United States, 98 F. 2d 88 (C.A. 2, 1938), cert. den. 305 U.S. 652; United States v. Northern Pacific Railway Co., 41 F. Supp. 273 (E.D. Wash. 1941).

III.

We note that the plaintiff Skokomish Indian Tribe has been incorporated as authorized in 25 U.S.C. 476, et seq. The statute in effect empowers the incorporated Tribe to manage its property, to assert and protect its property rights and to retain counsel for that purpose. Clearly, the Tribe has the capacity to bring this action on its own behalf. The United States is not a necessary party, at least in the jurisdictional sense.

Choctaw and Chickasaw Nations v. Seitz, 193 F. 2d 456 (C.A. 10, 1951).

The Attorney General having declined to consent that the United States be joined as a party plaintiff to this cause of action, we respectfully request that the plaintiff's motion for that action be denied.

/s/ CHARLES P. MORIARTY,

United States Attorney,

/s/ CHARLES W. BILLINGHURST,

Assistant United States Attorney.

[Endorsed]: Filed August 1, 1957.

[Title of District Court and Cause.]

TRANSCRIPT OF COURT'S
ORAL DECISION

rendered in the above-entitled and numbered cause in the above-entitled Court before the Honorable George H. Boldt, United States District Judge, on Friday, August 2, 1957, at the United States Courthouse, Tacoma, Washington.

Appearances: On behalf of the Plaintiff: Keith, Winston & Repsold, Attorneys at Law, Paulsen Building, Spokane, Washington. On behalf of Defendant Marcus Nalley, et ux: Mr. Harry Sager, Henderson, Carnahan, Thompson & Gordon, Attorneys at Law, Puget Sound Bank Building, Tacoma, Washington. On behalf of the Defendant State of Washington: Mr. E. P. Donnelly, Asst. Attorney General, Temple of Justice, Olympia, Washington. On behalf of the Defendants Carl J. Macke, et al.: Mr. W. E. Evenson, Skeel, McKelvy, Henke, Evenson, & Uhlmann, Attorneys at Law, Dexter Horton Building, Seattle, Washington. On behalf of the Defendant City of Tacoma: Mr. Robert R. Hamilton, Tacoma City Attorney, Tacoma City Hall, Tacoma, Washington. On behalf of the United States: Mr. Charles Billinghurst, Assistant United States Attorney, United States Courthouse, Tacoma, Washington.

The Court: The questions posed here are ex-

tremely difficult, at least to my limited understanding. I am trying to seek a practical solution. It is very regrettable that jurisdictional questions should not have been threshed out eight and half years ago shortly after the litigation was first commenced rather than now. However, I can't be charged with responsibility for that since I haven't held office anywhere near that long. Perhaps I can be charged with the responsibility of not looking into this the first time the matter was brought to my attention, but I suppose I had a right to assume that jurisdictional challenges had been resolved long prior to that time. In any case, I did so assume and, apparently, mistakenly.

My impression is that by implication the United States can be made a party but that implication will have to be drawn by a loftier tribunal than now sits. My second impression is that under the circumstances the United States is not an indispensable party. I rather go along with the reasoning of that Seitz case on that point, but here again, a loftier tribunal will have to resolve the question because to my mind, there are conflicting things said in these various decisions with respect to the United States as an indispensable party in this type of situation.

If I take jurisdiction when I have grave doubts about it, and go ahead and hear the case on its merits, we will be involved in a lengthy trial of numerous involved and complicated issues, putting many people to substantial additional expense be-

yond which that already occurred which will be wasted and lost if it ultimately be held there is no jurisdiction. On the other hand, if I resolve my doubt in favor of no jurisdiction, as has been the traditional practice of Federal District Courts, all of the questions presented can be reviewed and determined; namely, whether the State is properly a party, whether or not the United States is an indispensable party, and if so, can be joined without the consent of the attorney general, and so on.

(Discussion off the record.)

The Court: In view of the grave doubt I have concerning the jurisdictional questions involved here, I will deny the motion to make the United States a party, allow an exception; grant the motion of the State to be dismissed for want of consent to be sued; and hold that with the balance of the litigation there is a want of jurisdiction in this Court to hear and try the issue.

Accordingly, the action is dismissed without prejudice. Exception allowed.

Recess subject to call.

Certificate

I, Gerald J. Popelka, Official Court Reporter, in and for the above-entitled Court do hereby certify that foregoing transcript of proceedings is a true and correct transcript.

/s/ GERALD J. POPELKA.

[Endorsed]: Filed October 2, 1957.

In the District Court of the United States, Western
District of Washington, Southern Division

No. 1183

THE SKOKOMISH INDIAN TRIBE,
Plaintiff,
vs.

E. L. FRANCE, Trustee, et al., Defendants.

ORDER OF DISMISSAL

Be It Remembered that the above entitled action was filed in this court on the day of....., 1948, by plaintiff; that thereafter motions to dismiss and objections to jurisdictions were filed separately by various of the numerous defendants, which objections and motions have been continued as contentions of defendants in the pretrial order hereafter mentioned, and a pretrial order having been settled and entered herein October 1, 1956, superseding the pleadings in this action, and this court, by its order and direction of October 3, 1956, having required the several parties to submit additional briefs in respect to defendants' contentions numbered 24, 25, 28 and 30, as set forth in said pretrial order, and this matter thereafter coming on for further hearing, this court on June 12, 1957, by its further memorandum decision directed that a show cause order should issue at plaintiff's request requiring the United States of America to appear and show cause why it should not be made an addi-

tional party to the action, and plaintiff having received from the United States Attorney a letter dated July 23, 1957 advising that the Department of Justice would object to jurisdiction over the United States in this action and would oppose any order that it be made a party to the action, and on July 25, 1957 the plaintiff then making a motion giving notice of hearing of a motion to amend its complaint for the purpose of adding the United States of America as an additional party plaintiff, and the matter having been further heard by this court on August 2, 1957, and the court's further oral memorandum decision having been then announced, now therefore, pursuant to the announced decision of this court on August 2, 1957, it is by the court hereby

Ordered:

1. The motion of plaintiff to add the United States of America as an additional party plaintiff be and the same is hereby denied.
2. The motion of the State of Washington to be dismissed for want of consent to be sued is granted.
3. As to the balance of the litigation, there is want of jurisdiction in the court to hear and try the issues and the action is hereby dismissed without prejudice.
4. Exception is allowed the plaintiff as to each and all of the above rulings.

Entered at Seattle, Washington, this 6th day of December, 1957.

/s/ GEO. H. BOLDT,
Judge.

[Endorsed]: Filed and Entered December 9, 1957.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that the Skokomish Indian Tribe, the plaintiff above named, does hereby appeal to the United States Court of Appeals for the Ninth Circuit from the Order of Dismissal entered in this action on the 6th day of December, 1957.

Dated this 3rd day of January, 1958.

/s/ LYLE KEITH,
LYLE KEITH & PATRICK H.
WINSTON,
KEITH, WINSTON & REPSOLD,
Attorneys for Plaintiff.

Affidavit of Mailing Attached.

[Endorsed]: Filed January 6, 1958.

[Title of District Court and Cause.]

BOND FOR COSTS ON APPEAL

Know All Men by These Presents:

That the Skokomish Indian Tribe, the plaintiff above named, as principal, and Fidelity & Casualty Company of New York, a corporation organized under the laws of the State of New York and authorized to transact the business of surety in the State of Washington, as surety, are held and firmly bound unto each and all of the defendants herein in the just and full sum of Two Hundred Fifty Dollars (\$250.00) for which sum, well and truly to be paid, we bind ourselves, our heirs, executors, administrators and successors, jointly and severally, firmly by these presents.

Sealed with our seals and dated this 3rd day of January, 1958.

The Condition of This Obligation Is Such, That, Whereas, on the 6th day of December, 1957, an Order of Dismissal was entered in the District Court of the United States for the Western District of Washington, Southern Division, in favor of the defendants in the above entitled cause and against the plaintiff above named; and

Whereas, the above named plaintiff, the principal herein, has heretofore given due and proper notice that it appeals from the said decision and judgment of the said District Court to the United States Court of Appeals for the Ninth Circuit;

Now, Therefore, if the said principal shall pay

to the said defendants above named all costs if the appeal is dismissed or the judgment affirmed or such costs as the appellate court may award if the judgment is modified not exceeding the sum of \$250.00, then this obligation to be void, otherwise to remain in full force and effect.

THE SKOKOMISH INDIAN
TRIBE,

/s/ By LYLE KEITH,
Its Attorney.

[Seal] FIDELITY AND CASUALTY
COMPANY OF NEW YORK,

/s/ By CHARLES CARROLL,
Attorney.

Countersigned:

McGOVERN-CARROLL COM-
PANY,

/s/ By CHARLES CARROLL,
Resident State Agents at Spokane,
Washington.

[Endorsed]: Filed January 6, 1958.

[Title of District Court and Cause.]

MOTION TO EXTEND TIME TO FILE REC-
ORD AND DOCKET CAUSE IN APPEL-
LATE COURT

The plaintiff, appellant, by its attorney of record,
move the Court for an Order Extending the Time

to file the record on appeal and docket the cause in the appellate court to and including the 5th day of April, 1958, upon the ground that the Notice of Appeal was filed on the 6th day of January, 1958, that forty days from that date have not yet elapsed and that additional time is necessary to properly prepare the record for the appellate court. This additional time is requested for the following reasons:

(1) The plaintiff tribe is presently considering the employment of a new counsel and such new counsel needs additional time within which to acquaint himself with the records and proceedings herein and to properly prepare the record for the appellate court.

(2) The present attorneys for the plaintiff are located a considerable distance apart and the plaintiff tribe is likewise located a considerable distance from either of its counsel rendering communication and consideration of the several items of appeal difficult and time consuming.

KEITH, WINSTON & REPSOLD,
/s/ By LEO J. DRISCOLL,
R. G. WIGGENHORN,
Attorneys for plaintiff-appellant.

[Endorsed]: Filed February 3, 1958.

[Title of District Court and Cause.]

ORDER EXTENDING APPELLANT'S TIME
FOR DOCKETING APPEAL AND FILING
RECORD ON APPEAL

This matter having come before the Court upon the motion of the plaintiff-appellant, by its attorneys of record, for an order extending the time for filing the record and docketing this cause in the appellate court and it appearing to the Court that 40 days have not elapsed since the notice of appeal was filed on the 6th day of January, 1958.

It Is Hereby Ordered that the time within which the plaintiff-appellant shall be required to file the record on appeal and docket this cause in the appellate court is hereby extended to and including the 5th day of April, 1958.

Done in Open Court this 1st day of February, 1958.

/s/ GEO. H. BOLDT,
Judge.

Presented by:

KEITH, WINSTON & REPSOLD,
/s/ By LEO J. DRISCOLL,
Attorney.

[Endorsed]: Filed February 3, 1958.

[Title of District Court and Cause.]

MOTION FOR ORDER DIRECTING TRANSMITTAL OF ORIGINAL RECORDS TO COURT OF APPEALS

Comes now the plaintiff, by and through its attorneys, and moves the Court for an order directing the Clerk to transmit to the United States Court of Appeals for the Ninth Circuit in their original form the Pretrial Order signed by the Court on October 1, 1956 and all of the exhibits in this case, the exhibits to be retained by the Clerk until the parties hereto have completed their briefs.

This motion is based on the files and records herein, and on the affidavit of P. H. Winston attached hereto and by this reference made a part hereof.

Dated this 28th day of April, 1958.

KEITH, WINSTON & REPSOLD,
/s/ By P. H. WINSTON,
R. G. WIGGENHORN,
Attorneys for Plaintiff-Appellant.

State of Washington,
County of Spokane—ss.

P. H. Winston, being first duly sworn, on oath deposes and says:

That he is one of the attorneys for the Skokomish Indian Tribe, plaintiff-appellant in the above proceeding; that the Pretrial Order signed by the

Court on October 1, 1956 is a voluminous document, only a small portion of which should be included in the printed record in the Court of Appeals, the balance to be made available to the Court in its original form insofar as it may be relevant; that the exhibits identified in said Pretrial Order are bulky and need not be included in the printed record, but should be forwarded to the United States Court of Appeals for consideration in their original form to the extent that they may be relevant, said exhibits consisting of the Charter, Constitution and By-Laws of the Skokomish Indian Tribe, copies of relevant treaties and executive orders, photostatic copies of maps, letters, plats, conveyances, photographs of the properties involved, certified records of other court proceedings, surveys and patents, treaties of other Indian tribes, and other voluminous materials which should be examined by the Appellate Court in their original form; and that, consequently, said Pretrial Order and all of said exhibits should be sent to the United States Court of Appeals in their original form so that plaintiff, as appellant in that court, may move for an order to be relieved from printing and reproducing said Pretrial Order and exhibits; that it may be necessary for the parties to consult the exhibits in connection with the preparation of their respective briefs, so that said exhibits should be returned by the Clerk of the District Court until the briefs are completed and then forwarded to the Court of Appeals.

/s/ P. H. WINSTON.

Subscribed and sworn to before me this 28th day of April, 1958.

[Seal] /s/ LEO J. DRISCOLL,
Notary Public in and for the State of Washington,
residing at Spokane.

[Endorsed]: Filed April 30, 1958.

[Title of District Court and Cause.]

ORDER DIRECTING TRANSMITTAL OF
ORIGINAL RECORDS TO COURT OF
APPEALS

This matter having come on before this Court on the motion of plaintiff for an order directing the Clerk to transmit certain original records in this case to the United States Court of Appeals for the Ninth Circuit, and the Court having considered said motion and the affidavit of P. H. Winston in support thereof, and the files and records in this cause, and being fully advised in the premises, now, therefore,

It Is Hereby Ordered that the Clerk of this Court send to the Clerk of the United States Court of Appeals for the Ninth Circuit in their original form the Pretrial Order signed by the Court on October 1, 1956 and all of the exhibits identified in said Pretrial Order, for the inspection of the Court of Appeals.

It Is Further Ordered that the Clerk shall hold the exhibits identified in said Pretrial Order, which

are ordered to be transmitted in original form in the preceding paragraph, until such time as the parties have completed their briefs in this case, at which time the exhibits shall be transmitted to the Court of Appeals in accordance with the preceding paragraph of this order.

Done in Open Court this 30th day of April, 1958.

/s/ GEO. H. BOLDT,
Judge.

Submitted by:

KEITH, WINSTON & REPSOLD,
/s/ By P. H. WINSTON,
Attorneys for Plaintiff-Appellant.

[Endorsed]: Filed April 30, 1958.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO
RECORD ON APPEAL

United States of America,
Western District of Washington—ss.

I, John A. Burns, Clerk of the above entitled Court, do hereby certify that pursuant to the provisions of Rule 75(o) of the Federal Rules of Civil Procedure as amended, and Subdivision 1 of Rule 10, as amended, of the United States Court of Appeals for the Ninth Circuit, I am transmitting herewith such of the original papers and pleadings in the above entitled cause as are designated by Plain-

tiff's Designation of Record on Appeal (except the designated original exhibits which are retained by the Clerk of this Court, pursuant to Order, until the parties hereto have completed their briefs), and the said papers and pleadings constitute the Record on Appeal from that certain Order of Dismissal of the above entitled Court, filed and entered on December 9, 1957, to the United States Court of Appeals for the Ninth Circuit at San Francisco, and are identified as follows:

1. Complaint (filed Dec. 3, 1948).
2. Notice of Appearance on behalf of the State of Washington (filed July 14, 1949).
3. Motion of State of Washington to Dismiss (filed Apr. 27, 1951).
4. Memorandum Opinion and Order Denying Motions to Dismiss Complaint (filed July 29, 1952).
5. Pretrial Order (filed and entered Oct. 1, 1956).
6. Transcript of the Court's Oral Decision (filed July 25, 1957).
7. Motion of Plaintiff for Order to Join United States as Additional Party Plaintiff (filed July 31, 1957).
8. Memorandum of United States Attorney (filed Aug. 1, 1957).
9. Transcript of Court's Oral Decision (filed Oct. 2, 1957).
10. Order of Dismissal (filed and entered on Dec. 9, 1957).
11. Plaintiff's Notice of Appeal (filed Jan. 6, 1958).

12. Bond for Costs on Appeal (filed Jan. 6, 1958).

13. Motion to Extend Time to File and Docket Cause in Appellate Court (filed Feb. 3, 1958).

14. Order Extending Appellant's Time for Docketing Appeal, etc. (filed Feb. 3, 1958).

15. Motion for Order For Transmittal of Original Records (filed Apr. 30, 1958).

16. Plaintiff's Statement of Points to be Raised on Appeal (filed Apr. 30, 1958).

17. Order for Transmittal of Original Records and Directing Clerk of District Court to Retain Original Exhibits until Parties have Completed Briefs (filed April 30, 1958).

18. Plaintiff's Designation of Record on Appeal (filed Apr. 30, 1958).

I do further certify that the following is a true and correct statement of all expenses, costs, fees and charges incurred in my office on behalf of the parties hereto for the preparation of the Record on Appeal, to wit: Plaintiff's Notice of Appeal: \$5.00, and that the said fee has been paid to the Clerk by the Plaintiff.

In Witness Whereof I have hereunto set my hand and affixed the official seal of the said District Court, at Tacoma, Washington, this 1st day of May, 1958.

[Seal]

JOHN A. BURNS,

Clerk,

/s/ By E. E. REDMAYNE,

Deputy.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO SUPPLEMENTAL RECORD ON APPEAL

United States of America,
Western District of Washington—ss.

I, John A. Burns, Clerk of the above entitled Court, do hereby certify that I did, on the 1st day of May, 1958, transmit to the United States Court of Appeals for the Ninth Circuit, such of the original papers and pleadings as were designated by Plaintiff's Designation of Record on Appeal, heretofore filed in the above entitled cause, and

I do further certify that I am this day transmitting herewith such additional original papers and pleadings as are designated by Defendants' Designation of Record on Appeal, filed on May 7, 1958, and the said papers and pleadings constitute the Supplemental Record on Appeal to the United States Court of Appeals for the Ninth Circuit, at San Francisco, and are identified as follows:

1. Stipulation re dismissal of United States (filed Feb. 18, 1949).
2. Order Dismissing United States as Party Defendant (filed and entered Mar. 17, 1949).
3. Motion of defendants Chapman to Dismiss Action (filed May 23, 1949).
4. Amended Motion of defendant Wright to Dismiss Action (filed Feb. 21, 1949).
5. Motion of defendants Nalley to Dismiss Action (filed Aug. 17, 1949).

6. Motion of defendants Worl, et al. to Dismiss Action (filed Dec. 28, 1949).

7. Memorandum Brief in support State's Motion to Dismiss (filed Apr. 27, 1951).

8. Motion, defendants Simpson Logging Company, et al. to Dismiss Action (filed June 4, 1951).

9. Motion, defendants Hunter to Dismiss Action (filed Feb. 10, 1954).

10. Motion and Affidavit of defendant Wright to Dismiss Action (filed Feb. 10, 1954).

11. Motion of defendants France, Trustee, et al., to Dismiss Action (filed Feb. 19, 1954).

12. Motion of defendants, Hanson, et al., to Dismiss Action (filed Feb. 19, 1954).

13. Motion, City of Tacoma, to Dismiss Action (filed Feb. 19, 1954).

14. Affidavit, W. L. Brown, Jr., in support Motion of City to Dismiss (filed Feb. 19, 1954).

15. Motion of defendant, State of Washington, to Dismiss Action (filed Feb. 20, 1954).

16. Motion of defendants Carlson, et al. to Dismiss Action (filed Feb. 23, 1954).

17. Order Denying Motion to Dismiss, etc. (filed and entered April 20, 1954).

18. Statement of defendant, State of Washington, re Jurisdiction (filed Mar. 16, 1955).

19. Letter from City Attorney, Tacoma, to Clerk, Dist. Court re call calendar, etc. (Received Oct. 6, 1955).

20. Motion, City of Tacoma, to Dismiss Action (filed July 23, 1956).

21. Affidavit of W. L. Brown, Jr. in support Motion (filed 7/23/56).

22. Reasons and Authorities in support of Motion of all defendants except State of Wash. to Dismiss (filed July 23, 1956).

23. Defendants' Designation of Record on Appeal (filed May 7, 1958).

In Witness Whereof I have hereunto set my hand and affixed the official seal of the said District Court, at Tacoma, Washington, this 13th day of May, 1958.

[Seal]

JOHN A. BURNS,

Clerk,

/s/ By E. E. REDMAYNE,

Deputy.

[Endorsed]: No. 16008. United States Court of Appeals for the Ninth Circuit. Skokomish Indian Tribe, Appellant, vs. E. L. France, Trustee, et al., Appellees. Transcript of Record. Appeal from the United States District Court for the Western District of Washington, Southern Division.

Filed and Docketed: May 5, 1958.

Supplemental Filed: May 19, 1958.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In The United States Court of Appeals
For The Ninth Circuit

No. 16008

THE SKOKOMISH INDIAN TRIBE,

Appellant,

vs.

E. L. FRANCE, TRUSTEE, et al.,

Appellees.

APPELLANT'S STATEMENT OF POINTS
AND DESIGNATION OF RECORD

Comes Now the appellant, by and through its attorneys of record, and as its Statement of Points to be Relied Upon on Appeal, states as follows:

1. The Court erred in denying Plaintiff's motion to make the United States a party.

2. The Court erred in granting the motion of the State of Washington to be dismissed for want of consent to be sued.

3. The Court erred in ruling that as to the balance of the litigation there was want of jurisdiction in the Court to hear and try the issue.

4. The Court erred in ruling that the United States is an indispensable party in this proceeding, or in the alternative, in refusing to rule that the United States is not an indispensable party.

5. The Court erred in refusing to rule that it had jurisdiction of the subject matter and of all the

parties to the action save the State of Washington and therefore had jurisdiction to proceed with the trial of the action as to such other parties despite the dismissal of the State of Washington.

6. The Court erred in dismissing the action of the Plaintiff.

Appellant, as its Designation of the Record on Appeal, designates for inclusion in the printed record on appeal the following portions of the record, proceedings, and evidence in this action:

1. The Complaint.
2. Notice of Appearance filed July 14, 1949, by the State of Washington.
3. Motion to Dismiss filed April 27, 1951, by the State of Washington.
4. Memorandum Opinion and Order Denying Motions to Dismiss Complaint signed by Judge Lindberg and filed July 24, 1952.
5. Pretrial Order filed October 1, 1956.
6. Plaintiff's Exhibits 1 through 15 and Defendants' Exhibits 1 through 46.
7. Transcript of the Court's comments in connection with the hearing of June 12, 1957.
8. Motion filed July 31, 1957, by plaintiff.
9. Memorandum filed August 1, 1957, by The United States of America.
10. Transcript of the Court's Oral Decision rendered August 2, 1957.

11. Order of Dismissal filed December 9, 1957.
12. Notice of Appeal filed January 6, 1958.
13. Bond for Costs on Appeal filed January 6, 1958.
14. Motion to Extend Time to File Record and Docket Cause in Appellate Court filed February 3, 1958.
15. Order Extending Appellant's Time for Docketing Appeal and Filing Record on Appeal filed February 3, 1958.
16. Motion for Order Directing Transmittal of Original Records to Court of Appeals.
17. Order Directing Transmittal of Original Records to Court of Appeals.
18. Plaintiff's Statement of Points to be Raised on Appeal.
19. Plaintiff's Designation of Record on Appeal.

Dated this 28th day of April, 1958.

KEITH, WINSTON & REPSOLD,
/s/ By P. H. WINSTON,
R. G. WIGGENHORN,
Attorneys for Plaintiff-Appellant.

[Endorsed]: Filed May 5, 1958. Paul P. O'Brien,
Clerk.

[Letterhead of City of Tacoma.]

DESIGNATION OF APPELLEE

July 11, 1958

Office of the Clerk
U. S. Court of Appeals
For the Ninth Circuit
San Francisco 1, California

Skokomish Indians v. France, et al., #16008.

Attention Honorable Paul P. O'Brien,

Dear Sir:

We received your letter of June 24, relating to the supplemental transcript of record in the above-entitled case, sent to us pursuant to the designation filed in the district court.

Although the designation was signed by members of this office, the designation of the transcript was for and on behalf of all of the defendants in the above-entitled proceeding. I have contacted the various attorneys representing the defendants and they have all indicated that they feel that the designation of the complete supplemental transcript which we designated in the district court should be printed. While we appreciate that the several memoranda in the transcript as designated ordinarily do not form a part of the printed transcript it was the consensus of the thinking of the attorneys for the defendants that in this particular action the inclusion of such memoranda was warranted, in view of the fact that the case had been

pending for approximately ten years and that, in the opinion of the defendants, the plaintiffs had been dilatory in processing the same. We would therefore appreciate your including the several memoranda as designated in the designation filed with the District Court in the printed transcript.

* * * * *

Yours very truly,

/s/ ROBERT R. HAMILTON,
Chief Assistant City Attorney.

RRH:r

[Endorsed]: Filed July 17, 1958. Paul P. O'Brien, Clerk.

In the
United States
Court of Appeals
For the Ninth Circuit

SKOKOMISH INDIAN TRIBE, *Appellant* }
v. } No. 16008.
E. L. FRANCE, *Trustee, et al., Appellees* }

UPON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE WESTERN
DISTRICT OF WASHINGTON, SOUTHERN
DIVISION

HONORABLE SAM M. DRIVER, JUDGE

BRIEF OF APPELLEE,
STATE OF WASHINGTON

JOHN J. O'CONNELL,
Attorney General,

H. T. HARTINGER,
Assistant Attorney General,

E. P. DONNELLY, -
Assistant Attorney General,
Attorneys for Appellee,
State of Washington.

Temple of Justice, Olympia, Washington.

In the
United States
Court of Appeals
For the Ninth Circuit

SKOKOMISH INDIAN TRIBE, <i>Appellant</i>	} No. 16008.
v.	
E. L. FRANCE, <i>Trustee, et al., Appellees</i>	

UPON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE WESTERN
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DIVISION

HONORABLE SAM M. DRIVER, JUDGE

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Attorneys for Appellee,
State of Washington.

Temple of Justice, Olympia, Washington.

INDEX

	Page
Statement of Pleadings and Facts.....	5
Questions Involved	8
Argument	9
There is no substantial federal question involved, and there- fore the court does not have jurisdiction of this case.....	9
Appellant is not an agency or officer of the United States and is not expressly authorized to sue by Act of Congress.....	10
In any event, the court does not have jurisdiction of the sovereign State of Washington which has not consented to be sued in this action.....	11
The State of Washington has not waived its immunity from suit, except in certain specified courts of the state.....	12
A statute defining the duty of the attorney general does not waive the state's immunity from suit.....	15
The attorney general could not waive the state's immunity from suit	17
The attorney general challenged the court's jurisdiction of this action as against the State of Washington at all times...	19
Argument in Answer to Appellant's Argument.....	23
Conclusion	33

TABLE OF CASES

1. Adams v. Bradley, 1 Fed. Cas. 93 (Case No. 48).....	16
2. Billings v. State, 27 Wash. 288, 67 Pac. 583.....	15
3. Blank v. Bitker (7 Cir. 1943), 135 F. (2d) 962, 966.....	20
4. Clark v. Barnard, 108 U. S. 436, 448.....	27
5. Columbia Steel v. State, 34 Wn. (2d) 700, 209 P. (2d) 482...	25
6. Corrigan v. Brown, 169 Fed. 477.....	32
7. Deere v. St. Lawrence River Power Co., 32 F. (2d) 550.....	9
8. Deseret Water, Oil & Irrigation Co. v. State of California, (CCA 9th Cir.), 202 Fed. 498, 500.....	18
9. Ford Co. v. Department of Treasury, 323 U. S. 459, 467, 468	11, 15, 16
10. George Bird, et al., Trustees, v. James M. Ashton, et al., 220 U. S. 604.....	9
11. Great Northern Ins. Co. v. Read, 322 U. S. 47, 54.....	12
12. In re Celestine, 114 Fed. 551.....	9
13. MacVeigh v. Division of Unemployment Compensation, 19 Wn. (2d) 383, 388, 142 P. (2d) 900.....	19
14. Mann v. Tacoma Land Company, 153 U. S. 273, 284.....	9, 30
15. Martinez v. Southern Ute Tribe, 249 F. (2d) 915, 919.....	10
16. McGilvra v. Ross, 215 U. S. 70.....	9
17. Missouri v. Fiske, 290 U. S. 18, 28, 29.....	26, 27, 30
18. Monaco v. Mississippi, 292 U. S. 313, 329.....	11
19. O'Connor v. Slaker, 22 F. (2d) 147.....	23
20. Orange Theatre Corp. v. Rayherstz (CCA 3rd Cir.), 139 F. (2d) 871, 874.....	19
21. Pape v. Armstrong, 47 Wn. (2d) 480, 489, 287 P. (2d) 1018...	14, 25
22. People v. Detroit, G. H. & M. Ry. Co., 157 Mich. 144, 121 N. W. 814, 819.....	23
23. Phelps v. Hanson, 163 F. (2d) 973.....	9

TABLE OF CASES—Continued

	<i>Page</i>
24. Riddoch v. State, 68 Wash. 329, 123 Pac. 450.....	14, 15
25. Shively v. Bowlby, 152 U. S. 1, 58.....	9, 24
26. State ex rel. Pierce County v. Superior Court, 86 Wash. 685, 691, 151 Pac. 108.....	28
27. State ex rel. Thielicke v. Superior Court, 9 Wn. (2d) 309, 114 P. (2d) 1001.....	14
28. State v. Satiacum, 50 Wn. (2d) 513, 314 P. (2d) 400.....	31
29. Teeters v. Henton, 43 F. (2d) 175.....	9
30. Title Guaranty & Surety Co. v. Guernsey, 205 Fed. 91, 94, 95	18
31. U. S. v. Ashton, 170 Fed. 509, 519, 520.....	9, 32
32. U. S. v. O'Brien, 170 Fed. 508.....	31
33. United States v. Minnesota, 270 U. S. 181, 195.....	30, 31
34. Washington Recorder Publishing Co. v. Ernst, 1 Wn. (2d) 545, 97 P. (2d) 116.....	14

TEXTBOOKS

12 A.L.R. (2d) 29.....	32
12 A.L.R. (2d) Anno. page 41	33
page 69	33
42 A.L.R. 1464.....	28
42 A.L.R. 1478.....	28, 29
42 A.L.R. 1484.....	29
50 A.L.R. 1408.....	28
42 Am. Jur., Public Lands, § 70, page 846.....	32
49 Am. Jur., States, Territories, and Dependencies, § 97, pp. 313 314	25, 26
49 Am. Jur., 314, States, Territories, and Dependencies, § 96.....	27
Kappler's Indian Affairs, Volume 1, p. 924.....	7
Pages 923, 925.....	8
Federal Indian Law (1958), 307.....	29

STATUTES

Laws of Washington, 1927, chapter 216.....	17
Laws of Washington, 1927, chapter 216, § 1, amending chapter 95, Laws of 1895 (p. 188).....	13
Laws of Washington, 1927, chapter 255.....	17
Laws of Washington, 1927, chapter 255, § 194.....	15
Revised Code of Washington: RCW 4.92.010	13, 14, 15
RCW 79.01.704	15
48 Stat. 984.....	5

STATUTES—Continued

	<i>Page</i>
28 U. S. C. A. Rule 12.....	19
25 U. S. C. 70a.....	10
25 U. S. C. 476.....	5
28 U. S. C. 451, 62 Stat. 907.....	10
28 U. S. C. 1331.....	8
28 U. S. C. 1345.....	8
28 U. S. C. 1349.....	10
28 U. S. C. 1505.....	10

COURT RULES

Rules of Civil Procedure 12 (b).....	19
--------------------------------------	----

CONSTITUTIONS

Washington State Constitution:

Article XXVI, § 2.....	29
Article XVII, § 1.....	30
Article II, § 19.....	17
Article II, § 26.....	12

TREATIES

Article I of the treaty of 1855 (12 Stat. 933).....	6
Article II	6
Article VII	7

In the
United States
Court of Appeals
For the Ninth Circuit

SKOKOMISH INDIAN TRIBE, *Appellant* }
v. } No. 16008.
E. L. FRANCE, *Trustee, et al., Appellees* }

UPON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE WESTERN
DISTRICT OF WASHINGTON, SOUTHERN
DIVISION

HONORABLE SAM M. DRIVER, JUDGE

BRIEF OF APPELLEE,
STATE OF WASHINGTON

STATEMENT OF PLEADINGS AND FACTS

Appellant, plaintiff below, an Indian tribe incorporated under the provisions of an act of Congress (48 Stat. 984, 25 U.S.C. 476) brought this action in its own right (appellant's brief, p. 6).

The complaint was filed December 3, 1948, and a pretrial order was entered (R. 80-116), October 1, 1956.

Thereafter, on July 31, 1957, appellant filed a motion for an order requiring the United States to be made an additional party plaintiff, and that its complaint be amended to show that the United States held title in fee to the lands involved, and that the prayer of its complaint be amended to ask that the title of the United States to such lands be quieted, and the same held by the United States in trust for plaintiff (R. 125).

The attorney general of the United States objected to the joinder by written memorandum (R. 126).

The trial court denied the motion and dismissed the action without prejudice (R. 133).

By Article I of the treaty of 1855 (12 Stat. 933), a portion of which is printed as an appendix to appellant's brief beginning on page 45, the Skokomish Indian Tribe, with other tribes, ceded to the United States all right, title and interest of the said tribes and bands to any land in the Territory of Washington.

By Article II of said treaty, there was reserved for the present use and occupation of the tribes and bands of Indians six sections of land at the head of Hood's Canal "to be hereafter set apart, and so far as necessary surveyed and marked out for their exclusive use." (Appellant's brief, p. 47.)

The same article gave the president authority to place any other friendly tribe or band of Indians on the reservation and to allow them to occupy the same in common with the Indians signing the treaty.

Article VII of the treaty (not printed in the appendix to appellant's brief) gave the president the right to remove the Indians from land so reserved to other suitable places.

In accordance with the provisions of the treaty, the president of the United States, by executive order signed February 25, 1874 (Kappler's Indian Affairs, Volume I, p. 924) (R. 81), set apart for the use of the S'Klallam Indians a definite tract of land on Hood's Canal (including the six sections mentioned in the treaty), specifically describing and bounding the land as follows:

"Beginning at the mouth of the Skokomish River; thence up said river to a point intersected by the section line between sections 15 and 16 of township 21 north, in range 4 west; thence north on said line to a corner common to sections 27, 28, 33, and 34 of township 22 north, range 4 west; thence due east to the southwest corner of the southeast quarter of the southeast quarter of section 27, *the same being the southwest corner of A. D. Fisher's claim*; thence with said claim north to the northwest corner of the northeast quarter of the southeast quarter of said section 27; thence east to the section line between sections 26 and 27; thence north on said line to corner common to sections 22, 23, 26, and 27; *thence east to Hood's Canal; thence southerly and easterly along said Hood's Canal to the place of beginning.*" (Emphasis supplied.)

The underlining of the executive order is for the purpose of calling the attention of the court to the fact that the land set apart for the use of the S'Klallam Indians was specifically limited to a corner of a

donation claim, which corner was necessarily the line of ordinary high water, and that the tidelands were not set apart for the use of the Indians as they were in other executive orders. (See Quinaielt, Swinomish and Tulalip Reserves, Kappler, Vol. I, pp. 923, 925, all of which specifically set apart tidelands down to the low water mark.)

Appellant in this action seeks to quiet title in the United States to the tidelands below the line of ordinary high tide and above the line of low tide, notwithstanding the fact that these tidelands were not specifically set apart for the use of any tribe of Indians.

QUESTIONS INVOLVED

The questions involved are:

Does the court have jurisdiction of this cause of action, and, if so, does the court have jurisdiction against the sovereign State of Washington which is being sued in this action?

Jurisdiction is claimed:

(1) Under 28 U.S.C. 1331 on the ground that the interpretation of a treaty is involved; and

(2) under 28 U.S.C. 1345 in that the proceeding is one commenced by an agency or officer of the United States expressly authorized to sue by act of Congress.

ARGUMENT

THERE IS NO SUBSTANTIAL FEDERAL QUESTION INVOLVED, AND THEREFORE THE COURT DOES NOT HAVE JURISDICTION OF THIS CASE.

Since, under the executive order setting aside certain property for the use of Indians, the reservation was described as running to the corner of a donation claim and to Hood's Canal, it is no longer an open question but that the limit of the reservation is the line of ordinary high tide, and that tidelands do not form a portion of the reservation. There is, therefore, no substantial federal question involved and no jurisdiction.

The case of *U. S. v. Ashton*, 170 Fed. 509, is in point. Under the title of *George Bird, et al., Trustees, v. James M. Ashton, et al.*, 220 U. S. 604, the supreme court of the United States dismissed an appeal of this case for want of jurisdiction. In so doing the supreme court of the United States cited among others the case of *McGilvra v. Ross*, 215 U. S. 70, and *Shively v. Bowlby*, 152 U. S. 1, 58. See also *Mann v. Tacoma Land Company*, 153 U. S. 273, 284.

The mere fact that the action is brought by or in behalf of an Indian or Indian tribe does not confer jurisdiction on a federal court, and the mere fact that an Indian tribe's right of possession is guaranteed by a treaty with the United States does not confer original jurisdiction on a federal court. *Deere v. St. Lawrence River Power Co.*, 32 F. (2d) 550; *Teeters v. Henton*, 43 F. (2d) 175; *Phelps v. Hanson*, 163 F. (2d) 973; *In re Celestine*, 114 Fed. 551.

APPELLANT IS NOT AN AGENCY OR OFFICER OF THE UNITED STATES AND IS NOT EXPRESSLY AUTHORIZED TO SUE BY ACT OF CONGRESS.

Appellant is not a corporation in which the government has a proprietary interest and is, therefore, not an agency of the United States as defined in 28 U.S.C. 451, 62 Stat. 907.

The jurisdiction of federal courts in actions brought by a corporation on the ground that it was organized under an act of Congress is limited by act of Congress to cases where the United States is the owner of more than one-half of the corporate stock. 28 U.S.C. 1349; *Martinez v. Southern Ute Tribe*, 249 F. (2d) 915, 919.

No act of Congress expressly authorizing appellant to sue is cited in appellant's brief, and it is respectively submitted that none exists.

On the other hand, Congress has created the Indians Claims Commission with the authority and duty to hear and determine all claims against the United States made on behalf of any Indian tribe, specifically including claims arising under the constitution, laws, treaties of the United States, and executive orders of the president. 25 U.S.C. 70a; 28 U.S.C. 1505.

It is respectively submitted that this action does not involve the interpretation of a treaty so as to vest the court with jurisdiction, and that appellant is neither an agency nor an officer of the United

States, nor expressly authorized to sue by act of Congress, and that the dismissal of this action was correct.

IN ANY EVENT, THE COURT DOES NOT HAVE JURISDICTION OF THE SOVEREIGN STATE OF WASHINGTON WHICH HAS NOT CONSENTED TO BE SUED IN THIS ACTION.

Counsel for the State of Washington maintained their objection to the jurisdiction of this court on the ground that the state had not consented to be sued at all times in responsive pleadings and negotiations for a pretrial order.

The question is, however, so important that it would have been considered if raised for the first time on appeal. *Ford Co. v. Department of Treasury*, 323 U. S. 459, 467.

Because counsel for appellant admit that the State of Washington may not be sued without its consent (appellant's brief, p. 30), we will simply give one quotation from *Monaco v. Mississippi*, 292 U. S. 313, 329, which the State of Washington called to the attention of the trial court:

"Protected by the same fundamental principle, the States, in the absence of consent, are immune from suits brought against them by their own citizens or by federal corporations, although such suits are not within the explicit prohibitions of the Eleventh Amendment. *Hans v. Louisiana*, *supra* [134 U. S. 1]; *Smith v. Reeves*, *supra* [178 U. S. 436]; *Duhne v. New Jersey*, *supra* [251 U. S. 311, 314]; *Ex parte State of New York, No. 1*, *supra* [256 U. S. 490, 498]." (Citations supplied.)

The foregoing quotation appears in the record at page 64 as a part of the "STATEMENT OF DEFENDANT, STATE OF WASHINGTON AS TO ITS POSITION ON JURISDICTION." (R. 64-70.) This statement of the State of Washington was filed during consultations regarding the contents of a pretrial order when it appeared that appellant intended to assert title to tidelands belonging to the state.

A motion to dismiss for lack of jurisdiction had been filed by the State of Washington on April 27, 1951 (R. 42), prior to the settlement of any issues, and a memorandum brief in support of this motion was filed (R. 42-45).

THE STATE OF WASHINGTON HAS NOT WAIVED ITS IMMUNITY FROM SUIT, EXCEPT IN CERTAIN SPECIFIED COURTS OF THE STATE.

A state may consent to be sued only in its own courts, in which event suit may not be maintained in federal courts. A clear declaration of a state's intention to submit its affairs to other courts than those of its own creation is necessary before it will be deemed to have waived its immunity from suit. *Great Northern Ins. Co. v. Read*, 322 U. S. 47, 54.

The legislature of the State of Washington has specifically limited its waiver of immunity from suit, and under the authority of Article II, § 26, of the Washington State Constitution, has definitely designated "in what courts, suits may be brought against the state."

The only act of the legislature authorizing suits against the state is chapter 95, Laws of 1895 (p. 188), as amended by chapter 216, Laws of 1927, now codified as RCW 4.92.010.

The title to the act of 1895 is:

“AN ACT authorizing actions against the state.”

Section 1 thereof reads in part as follows:

“Any person or corporation having any claim against the State of Washington shall have the right to begin an action against the state in the superior court of Thurston county.
* * * ”

Before the passage of this act the State of Washington could not be sued in any court. After the passage of this act the state could be sued in the superior court of Thurston County, Washington only.

The title to the amending act of 1927 (chapter 216, p. 331) reads as follows:

“AN ACT relating to, and authorizing and governing, actions against the State of Washington, and amending Sections 1 and 2 of Chapter XCV of the Laws of 1895.”

Section 1 of this act again provides that a person having a claim against the state shall have a right of action in the superior court of Thurston County, Washington, but provides that actions against the state affecting title to real property may be brought in the county where the property is situated.

After the amendment of 1927, all actions against the State of Washington must still be brought

in the superior court of Thurston County, Washington, unless they involve title to real property, in which event they may be brought in the superior court of that county in the State of Washington in which the real property is situated.

Contrary to the statement made by counsel for appellant on page 30 of their opening brief, the state courts designated are the exclusive forum in which a suit against the state may be brought.

The state cannot be sued without its consent and then only in the manner and to the extent provided by statute. *Pape v. Armstrong*, 47 Wn. (2d) 480, 489, 287 P. (2d) 1018.

This statute waiving the state's immunity from suit in the superior court of Thurston County is one of jurisdiction, and the superior court of Thurston County may not grant a change of venue so that the action could be tried in another county of the state. *State ex rel. Thielicke v. Superior Court*, 9 Wn. (2d) 309, 114 P. (2d) 1001.

The statute waiving the state's immunity from suit in the superior court of Thurston County did not create a new liability, and hence the state may not be sued for tort in any county (*Riddoch v. State*, 68 Wash. 329, 123 Pac. 450), nor is it liable for interest (*Pape v. Armstrong, supra*), nor costs (*Washington Recorder Publishing Co. v. Ernst*, 1 Wn. (2d) 545, 97 P. (2d) 116).

Counsel for appellant argue that RCW 4.92.010

does not prohibit an action against the state in the federal court. (Appellant's brief, p. 32.)

This argument overlooks the sovereign state's immunity from suit in any court. The state has not waived its immunity from suit in the United States district court and may, therefore, not be sued therein.

In *Riddoch v. State*, 68 Wash. 329, 332, 123 Pac. 450, the supreme court of the State of Washington pointed out that RCW 4.92.010 does not waive any defense the state may have (quoting *Billings v. State*, 27 Wash. 288, 67 Pac. 583). Certainly it did not waive the defense of want of jurisdiction over the sovereign state.

A STATUTE DEFINING THE DUTY OF THE ATTORNEY GENERAL DOES NOT WAIVE THE STATE'S IMMUNITY FROM SUIT.

Counsel for appellant point to § 194, chapter 255, Laws of Washington for 1927 (now codified as RCW 79.01.704), making it the duty of the attorney general to institute or defend any action in which the interests of the state are involved, in the courts of any state or of the United States.

The argument seemingly advanced on page 31 of the appellant's brief is that this statute makes it mandatory for the attorney general to defend cases against the state, on the merits, in courts which lack jurisdiction.

This argument was considered and repulsed by the supreme court of the United States in *Ford Co.*

v. Department of Treasury, 323 U. S. 459, where the court said on page 468:

“ * * * Since the state legislature may waive state immunity only by general law, it is not to be presumed in the absence of clear language to the contrary, that they conferred on administrative or executive officers discretionary power to grant or withhold consent in individual cases. Nor do we think that any of the general or special powers conferred by statute on the Indiana attorney general to appear and defend actions brought against the state or its officials can be deemed to confer on that officer power to consent to suit against the state in courts when the state has not consented to be sued. * * * ”

In the early case of *Adams v. Bradley*, 1 Fed. Cas. 93 (Case No. 48), the court considered the authority of the attorney general to waive the state's immunity from suit under a statute making it the duty of the attorney general to represent the state in bringing suits and defending the same, and said (p. 96):

“ * * * The state cannot be made a party at all, without its consent, and the assumed appearance of the district attorney or attorney-general, without express authority of law, does not constitute a consent. I do not think the provision in the statute of Nevada, in regard to the duties of the attorney-general, touches the question. *It might be the duty of the attorney-general to appear and make the objection that the state cannot be sued*, and even to conduct the defense for the benefit of the state. But it is a general law, such as exists in most if not all the states defining the duties of the attorney-general, to appear and defend the interests of

the state in those cases where the state may be rightfully sued. * * * However this may be, it is clear that this section of the statute does not in terms, or by any reasonable implication authorize private parties to sue the state; and we have seen from the authorities cited, that where there is no authority of law for suing the state, an assumed authority of an attorney of the state to appear does not confer jurisdiction over the state. * * * ” (Emphasis supplied.)

Chapter 255, Laws of Washington for 1927, does not waive the state's immunity from suit nor authorize any state officer to do so. No such purpose is expressed in the title as required by Article II, § 19, of the Washington State Constitution.

Chapter 255, Laws of Washington for 1927, was passed at the same session of the legislature which amended the consent-to-suit statute (chapter 216, Laws of Washington for 1927).

Each act had its separate, specific purpose. Chapter 216 specifically authorizes suits against the state in certain state courts only. Chapter 255 deals with the management of state property and the duty of certain state officers in connection therewith.

THE ATTORNEY GENERAL COULD NOT WAIVE THE STATE'S IMMUNITY FROM SUIT.

The appearance of the attorney general in this action could not confer upon the court jurisdiction which it does not have.

In *Deseret Water, Oil & Irrigation Co. v. State of California* (CCA 9th Cir.), 202 Fed. 498, 500, the court said:

“Again, the effect of the appearance in the case of the Attorney General on behalf of the state must be limited by the terms of the statute of the state whereby it consented to be sued. Section 1240 of the Code of Civil Procedure of California authorizes the condemnation of state lands to a public use when not devoted to other public uses; and section 1243 provides that ‘all proceedings under this title must be brought in the superior courts of the counties in which the property is situated.’ This is a consent to be sued only in a court of the state, and in that respect the case is similar to that which was before this court in *Smith v. Rackliffe*, 87 Fed. 964, 31 C. C. A. 328, affirmed in *Smith v. Reeves*, 178 U. S. 436, 20 Sup. Ct. 919, 44 L. Ed. 1140, in which it was held that it was competent for the state to couple with its consent to be sued the condition that the suit be brought in one of its own courts.”

In *Title Guaranty & Surety Co. v. Guernsey*, 205 Fed. 91, 94, a case in the United States district court for the western district of Washington, it was held that the state’s immunity from suit could not be waived by the attorney general. In this case the objection to jurisdiction was raised after the state had filed an answer and cross-bill. The court said in its second opinion appearing in 205 Fed. at page 95:

“It would have, perhaps, been more seemly had the Attorney General challenged the jurisdiction of the court at the threshold; but the immunity of the state from suit can only be waived by the Legislature, and it is in no manner bound or estopped by the acts of its officers.* * *”

The holdings of the supreme court of the State of Washington are to the same effect. The appearance of the attorney general cannot confer jurisdiction. *MacVeigh v. Division of Unemployment Compensation*, 19 Wn. (2d) 383, 388, 142 P. (2d) 900.

THE ATTORNEY GENERAL CHALLENGED THE COURT'S JURISDICTION OF THIS ACTION AS AGAINST THE STATE OF WASHINGTON AT ALL TIMES.

The record will show that the only relief asked by the state in this case was and is that the action as against it be dismissed on the ground that the state had not consented to be sued, and that the court lacked jurisdiction.

On the 9th day of May, 1949, the State of Washington filed and served upon counsel for plaintiff its notice of appearance and request that all further pleadings be served upon said defendant at the office of the attorney general, Olympia, Washington (R. 38).

No relief was asked for.

It was not necessary that this notice of appearance be specifically denominated as a special appearance. Rule of Civil Procedure 12(b), (28 U. S. C. A. Rule 12)

In the case of *Orange Theatre Corp. v. Rayherstz* (CCA 3rd Cir.), 139 F. (2d) 871, 874, the court said:

"It necessarily follows that Rule 12 has abolished for the federal courts the age-old distinction between general and special appear-

ances. A defendant need no longer appear specially to attack the court's jurisdiction over him. * * * ”

The court cited *Blank v. Bitker* (7 Cir. 1943), 135 F. (2d) 962, 966, to the same effect.

The state's first responsive pleading was a motion to dismiss on the ground that the court was without jurisdiction over the sovereign state (R. 42). A brief supporting this motion was also filed on the same day (R. 42-45).

On February 20, 1954, a second motion to dismiss was filed on the ground that the court lacked jurisdiction, the state not having consented to be sued or waived its immunity from suit (R. 60).

The trial court ordered a pretrial conference for the 17th day of May, 1954, and specifically provided (R. 63) :

“Ordered that upon the pretrial conference on the 17th day of May, 1954, the defendant, State of Washington, may renew its motion to dismiss the above entitled action as to such defendant on the ground that this Court has no jurisdiction in this action over the State of Washington.”

On March 16, 1955, the State of Washington filed the following statement of its position on jurisdiction (R. 64) :

“Counsel for the State of Washington are advised that the pretrial order now being prepared will show that plaintiff intends to assert title to tidelands belonging to the sovereign State of Washington and, therefore, feel it their

duty to suggest to the court in the words of the Rule of Civil Procedure 12 (h) that since the sovereign State of Washington has consented to be sued only in the superior court of that county of the State of Washington in which the property is situated (RCW 4.92.010) this court, if it has jurisdiction as against defendants other than the State of Washington, has no jurisdiction as to the sovereign State of Washington."

This statement was followed by a brief citing cases on which the state relied (R. 64-70).

On July 23, 1956, counsel for all defendants, except the State of Washington, made a motion to dismiss for want of prosecution (R. 72).

A brief was filed in support of this motion (R. 75-79). In this brief the following statement was made with respect to the position of the State of Washington (R. 75-76):

"The State of Washington does not join herein because the State has made a continuing objection as to the jurisdiction of the above-entitled Court over the State of Washington in this action."

A pretrial order was filed on October 1, 1956 (R. 80-116). This pretrial order, approved by all counsel including counsel for appellant, contains the following statement of fact (R. 115):

"Defendant State of Washington, at all times continuing its objection to any jurisdiction of this court over the sovereign State of Washington, by participating in the entry of this pretrial order, conferences therefor, or in approving this order, does not thereby consent

to such jurisdiction nor join in any contentions expressed by any of the defendants for affirmative relief, such as for the designation of a commission of land surveyors or any other relief whatsoever."

The contention of the State of Washington appears as Paragraph 25 of the defendants' contentions (R. 93) and is as follows:

"The court is without jurisdiction of the sovereign State of Washington, it not having consented to be sued in this court nor waived its immunity from suit."

The issue of law as claimed by the State of Washington is stated as follows (R. 100):

"1. Does the court have jurisdiction in this action of the State of Washington?"

Appellant did not contend in this pretrial order that the state had waived its immunity from suit (R. 82) nor make that argument an issue to be presented to the court (R. 99).

Following the entry of the pretrial order, the court considered the question of jurisdiction before considering the merits and granted the only motion which the state had made, namely, for dismissal for want of jurisdiction.

ARGUMENT IN ANSWER TO APPELLANT'S ARGUMENT

Appellant now argues "that the State of Washington has consented to this action against it in the manner of its appearance and handling of this lawsuit." (Appellant's brief, p. 30.)

Apparently to support this argument appellant quoted from *People v. Detroit, G. H. & M. Ry. Co.*, 157 Mich. 144, 121 N. W. 814, 819. This was a case in which the State of Michigan, acting through its attorney general, appealed to the supreme court of the United States from a ruling of the lower federal court. The attorney general of Michigan invoked the jurisdiction of the federal court and asked that court to rule on the merits.

He then sought to disregard the ruling of the federal court and bring the same cause of action in the state courts. The supreme court of Michigan pointed out that the state, having appealed to the supreme court of the United States, was the moving party in the federal court action and rightfully held that the judgment in the federal court was *res judicata*.

In *O'Connor v. Slaker*, 22 F. (2d) 147, the court of appeals for the eighth circuit considered an objection to the jurisdiction of the court over the State of Nebraska which was raised for the first time on appeal, holding that if the trial court was without jurisdiction, it could not decide the case as to the state even with the consent of the parties.

In the case at bar, objection to the jurisdiction was made before any action was taken in the case and was preserved throughout.

Counsel for appellant suggest (appellant's brief, p. 32) that the state is "involved in its proprietary rather than its governmental interest" in the case at bar. The state has not waived its immunity from suit in the federal court in any capacity.

However, we cannot admit that the state in holding title to tidelands which it does by virtue of its inherent sovereignty is acting in a proprietary capacity.

The supreme court of the United States considered the nature of the state's title to tidelands in the case of *Shively v. Bowlby*, 152 U. S. 1, and referring to them, said (p. 43) :

" * * * It properly belongs to the States by their inherent sovereignty, and the United States has wisely abstained from extending (if it could extend) its survey and grants beyond the limits of high water. * * * "

In holding that the United States held title to tidelands in trust for the future states, the court further said (p. 49) :

"The Congress of the United States, in disposing of the public lands, has constantly acted upon the theory that those lands, whether in the interior, or on the coast, above high water mark, may be taken up by actual occupants, in order to encourage the settlement of the country; but that the navigable waters and the soils under

them, whether within or above the ebb and flow of the tide, shall be and remain public highways; and, being chiefly valuable for the public purposes of commerce, navigation and fishery, and for the improvements necessary to secure and promote those purposes, shall not be granted away during the period of territorial government; but, unless in case of some international duty or public exigency, shall be held by the United States in trust for the future States, and shall vest in the several States, when organized and admitted into the Union, with all the powers and prerogatives appertaining to the older States in regard to such waters and soils within their respective jurisdictions; in short, shall not be disposed of piecemeal to individuals as private property, but shall be held as a whole for the purpose of being ultimately administered and dealt with for the public benefit by the State, after it shall have become a completely organized community."

Counsel for appellant have cited two Washington cases on page 32 of their brief: *Pape v. Armstrong*, 47 Wn. (2d) 480, 287 P. (2d) 1018 (1955), and *Columbia Steel Co. v. State*, 34 Wn. (2d) 700, 209 P. (2d) 482 (1949).

These cases are simply authority for the proposition that the state cannot be sued without its consent and then only in the manner and to the extent provided by statute and is, therefore, not liable for interest since the statute waiving the state's immunity from suit in the superior court of Thurston County, Washington, did not provide for interest.

On page 33 of appellant's brief, counsel quote from 49 Am. Jur., States, Territories, and Depen-

dencies, § 97, pp. 313, 314, to the effect that a state's appearance in a court is a voluntary submission to its jurisdiction.

The truth of this general statement depends upon, of course, the nature of the appearance, and the appearance referred to by the text writer is an appearance in the nature of an intervention as will be seen from the cases cited in the footnote supporting this statement.

The first case cited by the text writer is *Missouri v. Fiske*, 290 U. S. 18. In that case the State of Missouri moved to intervene in a federal court proceeding asking only that certain stock should not be distributed until the right thereto could be determined in a state court proceeding. The court held that this was too limited an intervention to constitute a waiver of the state's immunity from suit (p. 25), and held that the trial court did not have jurisdiction over the state, even to protect its own decree, where the state had not waived its immunity from suit. In this case the court also pointed out that the nature of the suit has nothing to do with the jurisdiction of federal courts over nonconsenting states. On page 28 of the decision we find the following language:

"The fact that a suit in a federal court is *in rem*, or *quasi in rem*, furnishes no ground for the issue of process against a non-consenting State. If the State chooses to come into the court as plaintiff, or to intervene, seeking the enforcement of liens or claims, the State may be permitted to do so, and in that event its rights will

receive the same consideration as those of other parties in interest. But when the State does not come in and withholds its consent, the court has no authority to issue process against the State to compel it to subject itself to the court's judgment, whatever the nature of the suit. * * * [citing cases]"

In the second of the cases cited by the text writer, *Clark v. Barnard*, 108 U. S. 436, the State of Rhode Island intervened asking for affirmative relief. The supreme court, after pointing out that federal courts are always open to states as suitors or plaintiffs, said (p. 448):

" * * * In the present case the State of Rhode Island appeared in the cause and presented and prosecuted a claim to the fund in controversy, and thereby made itself a party to the litigation to the full extent required for its complete determination. It became an actor as well as defendant, as by its intervention the proceeding became one in the nature of an interpleader, in which it became necessary to adjudicate the adverse rights of the State and the appellees to the fund, to which both claimed title. The case differs from that of *Georgia v. Jesup*, 106 U. S. 458, where the State expressly declined to become a party to the suit, and appeared only to protest against the exercise of jurisdiction by the court. * * * "

In the case at bar the State of Washington appeared only to protest against the exercise of jurisdiction, and there could be therefore no waiver of immunity.

49 Am. Jur. 314, States, Territories, and Dependencies, § 96, from which counsel for appellant

quote, contains the following statement regarding the authority of the attorney general:

“ * * * Unless duly authorized by law, the general rule is that the attorney general cannot waive the state's immunity from suit and bind it by appearing in actions so as to give the court jurisdiction. * * * ”

It goes without saying that had the attorney general failed to object, the court would not have acquired jurisdiction as a result of such failure.

In the case of *State ex rel. Pierce County v. Superior Court*, 86 Wash. 685, 691, 151 Pac. 108, the supreme court of the State of Washington said:

“ * * * Here the suit is against the sovereign state, which can only be sued in a particular place, in a particular manner, and (in cases such as the case in question) by a specially designated person. Clearly no officer of the state has power, by mere failure to object, to permit the state to be sued in any other or different manner, or by any other or different person than it has itself permitted. We think, therefore, that the court in which the action is pending not only has the power to call in question, but owes to itself and to the state the duty of calling in question, the right of the plaintiff to maintain the action.”

On page 33 of their brief counsel have called the court's attention to 42 A. L. R. 1464 and 50 A. L. R. 1408. We have carefully read these annotations and find nothing therein which would support any of the arguments made by counsel for appellant in this case.

In 42 A. L. R. 1478 we find the following statement by the annotator:

“Where the consent indicates a state court, the Federal court has no jurisdiction. *Smith v. Reeves* (1900) 178 U. S. 436, 44 L. ed. 1140, 20 Sup. Ct. Rep. 919; *Chandler v. Dix* (1904) 194 U. S. 590, 48 L. ed. 1129, 24 Sup. Ct. Rep. 766; *Deseret Water, Oil & Irrig. Co. v. State* (1913) 120 C. C. A. 641, 202 Fed. 498; *Title Guaranty & S. Co. v. Guernsey* (1913; D. C.) 205 Fed. 94.”

The federal and state cases supporting the proposition that the attorney general may not waive the state's immunity from suit, unless duly authorized by law so to do, will be found collected in 42 A. L. R. 1484.

Lastly, counsel for appellant refer to the merits and justice of appellant's suit, saying on page 37 of their brief:

“ * * * It would be a travesty of justice if the State, having entered a solemn compact to respect the rights of Indians to their lands, were to be permitted to nullify this guaranty by asserting a claim of immunity from suit. *
* * ”

The compact referred to is a compact with the United States contained in Article XXVI, § 2, of the Washington State Constitution which disclaims the right of the state to unappropriated public lands owned or held by any Indian or Indian tribe.

The United States Department of the Interior has just published for the year 1958 its treatise entitled “Federal Indian Law” in which we find the following statement on page 307:

“Congress already has given its consent to

all States to assume jurisdiction with respect to criminal offenses or civil causes of action.⁶

⁶See sec. 7 of the act of August 15, 1953, 67 Stat. 588, 28 U. S. C. 1360 note."

Appellant's claim in this case is to tidelands, and the term "public lands" does not include tidelands. *Mann v. Tacoma Land Company*, 153 U. S. 273, 284.

The State of Washington specifically asserted its ownership to tidelands in Article XVII, § 1, of its constitution.

The State of Washington has waived its immunity from suit in the proper state court, and a remedy by appeal is available. *Missouri v. Fiske*, 290 U. S. 18, 29.

Appellee, United States, points out in its brief that the sovereign immunity from suit is the same whether Indians or other parties are involved (p. 5) and cites cases sustaining the proposition that "Consent alone gives jurisdiction to adjudge against a sovereign. Absent that consent, the attempted exercise of judicial power is void." (P. 4.)

We agree.

United States v. Minnesota, 270 U. S. 181, involved circumstances which made it proper for the United States to bring suit on behalf of tribal Indians. Objection was made to the United States bringing the action, and it was argued that the Indians could neither sue the State of Minnesota nor

the United States. The court defined the sovereign immunity from suit in these words (p. 195) :

“ * . * * The reason the Indians could not bring the suits suggested lies in the general immunity of the State and the United States from suit in the absence of consent. Of course the immunity of the State is subject to the constitutional qualification that she may be sued in this Court by the United States, a sister State, or a foreign State. *United States v. Texas*, 143 U. S. 621, 642, *et seq.* Otherwise her immunity is like that of the United States. * * * ”

Counsel for appellant have cited a number of cases which do not touch the question of jurisdiction or of the state's immunity from suit. None of these cases supports counsel's argument that jurisdiction depends upon which court, state or federal, an Indian might have chosen (appellant's brief, p. 35). The sovereign immunity from suit is absolute and unqualified.

State v. Satiacum, 50 Wn. (2d) 513, 314 P. (2d) 400 (1957) (see addendum, Hill, C. J. on p. 538), cited by counsel for appellant, decided nothing except that criminal charges against an Indian were properly dismissed. The Indian's rights were considered in state courts. The right of appeal exists. There is no support for the inference made by counsel for appellant on pages 36 and 37 of their brief that the Indian is without remedy or that the state claims absolute immunity from suit.

U. S. v. O'Brien, 170 Fed. 508, is cited on page 35 of appellant's brief. This case, together with the

case of *Corrigan v. Brown*, 169 Fed. 477, were explained by Judge Hanford (who wrote the opinions in these cases) in *U. S. v. Ashton*, 170 Fed. 509, on pages 519 and 520, in which the court pointed out that where, as in the case at bar, the Indian reservation runs to a body of water, its limits are the line of ordinary high tide.

Counsel for appellant argue that the United States District Court is the sole forum in which the title to tidelands lying within the state of Washington may be tried. (Br. p. 38.)

This argument is not well founded. The rule is stated in 42 Am. Jur., Public Lands, section 70, page 846, as follows:

“It is the rule that the courts of a state must determine the validity of titles to land lying in the state, although such titles emanated from the Federal Government or the controversy involves construction of Federal statutes, and they can determine between individuals the priority or validity of conflicting titles under different grants from the same antecedent source. In all such cases an appeal may be taken to the Supreme Court of the United States, but no branch of the Federal judiciary has been invested with original jurisdiction in such cases.”

On page 38 of appellant's brief there is a quotation from 12 A. L. R. (2d) 29 to the effect that the asserted or alleged federal question must be real and substantial to vest a federal court with original jurisdiction. With this we agree; however, this case does not arise out of a treaty. The test is the nature of the right plaintiff claims, not the source of the

authority to establish it. (See 12 A. L. R. (2d), Anno., p. 41).

In any event, the federal court has no original jurisdiction in an action against the state, even if the cause of action might be said to arise under the constitution laws or treaties. See 12 A. L. R. (2d) Anno., p. 69.

CONCLUSION

Counsel for appellees other than the State of Washington and the United States will file a separate, joint brief. While the state is in agreement with the position of these appellees and believes the judgment of the trial court to be correct in every particular, we deem it proper to confine ourselves to the question of jurisdiction against the sovereign state and respectfully submit that the action of the trial court in dismissing the case as against the sovereign state for want of consent to be sued is correct and should be affirmed.

Respectfully submitted,

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United States Court of Appeals
For the Ninth Circuit

SKOKOMISH INDIAN TRIBE, *Appellant*,

vs.

E. L. FRANCE, Trustee, *et al.*, *Appellees*.

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WESTERN DISTRICT OF WASHINGTON
SOUTHERN DIVISION
HONORABLE GEORGE H. BOLDT, *Judge*

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TABLE OF CONTENTS

Page

Motion to Dismiss Appeal

Motion	1
Points and Authorities.....	1

Answering Brief of Appellees

Introduction—Nature of Case.....	3
Pleadings	5
Statement of the Case.....	5
Amount of Tide Land Property Involved.....	6
Utility and Character of Tide Land Strip Not In- volved	7
Jurisdiction	7
Section 1345	8
Section 1349	8
Section 1331	8
Existence of a Federal Question.....	9
Complaint Fails to Show the Matter in Controversy Exceeds the Sum of \$3000.....	11
Title Necessarily in Appellees or United States and Not in Appellant.....	14
Equity Case—Appellant Must Prevail, If At All, on Strength of Own Title.....	16
Nonjoinder of United States—Indispensable Party	16
Dismissal of the United States.....	19
Prior Pending Action Warranted Dismissal of This Action	20
Aboriginal Rights	21
Dilatoriness	22
Conclusion	22

TABLE OF CASES

<i>Beck v. Johnson</i> (CC Ky. 1909) 169 Fed. 154.....	11
<i>Calvert Distillers Corp. v. Rosen</i> (N.D. Ill. 1953) 115 F.Supp. 146.....	12
<i>Celestine, In re</i> (D.C. Wash. 1902) 114 Fed. 551.....	9
<i>Choctaw v. Seitz</i> (CA-10 1951) 193 F.2d 456.....	17, 19

	<i>Page</i>
<i>Citizens Bank v. Cannon</i> , 164 U.S. 319.....	12
<i>Crystal Springs Land & Water Co. v. City of Los Angeles</i> (CC Cal. 1897) 82 Fed. 114, 117 affirmed 177 U.S. 169.....	10
<i>Deena Products Co. v. United Brick Workers</i> (CA-6 1952) 195 F.2d 612, cert. den. 344 U.S. 822.....	2
<i>Deere v. St. Lawrence River Power Co.</i> (CA-2 1929) 32 F.2d 550.....	9
<i>Devine v. Los Angeles</i> (1906) 202 U.S. 313.....	10
<i>Eisenbach v. Hatfield</i> (1891) 2 Wash. 236, 26 Pac. 539	14
<i>Erstling v. Southern Bell Co.</i> (CA-5 1958) 255 F.2d 93	2
<i>Essmon v. Hood</i> (N.D. Texas 1930) 45 F.(2d) 881....	12
<i>Fecheimer Bros. Co. v. Barnwasser</i> (6th Cir. 1945) 146 F.(2d) 974.....	12
<i>Fishback v. Western Union Telegraph Co.</i> , 161 U.S. 96, 16 S.Ct. 506.....	12
<i>Gerard v. Mercer</i> , 62 F.Supp. 28.....	19
<i>Gerard v. U. S.</i> , 167 F.2d 951.....	18, 19
<i>Grubb v. Public Utilities</i> (1930) 281 U.S. 470.....	21
<i>Hager v. Hanover Fire Ins. Co. of New York</i> (W.D. Missouri 1945) 64 F.Supp. 949.....	12
<i>Harkin v. Brundage</i> (1928) 276 U.S. 36.....	20
<i>Hynes v. Grimes Packing Co.</i> (1949) 337 U.S. 86, 43 L.ed. 1231	22
<i>Joy v. City of St. Louis</i> (1906) 201 U.S. 332.....	10
<i>Leonard v. Prince Line</i> (CA-2 1946) 157 F.2d 987.....	3
<i>Martinez v. Southern Ute Tribe</i> (CA-10 1957) 249 F.2d 915	8
<i>Mitchell v. Cunningham</i> (CA-9 1925) 8 F.2d 813.....	16
<i>Napier v. Delaware R. Co.</i> (CA-2 1955) 223 F.2d 28..	2
<i>Phelps v. Hanson</i> (CA-9 1947) 163 F.2d 973.....	9
<i>Pollard v. Hagen</i> (1845) 3 How. 212, 11 L.ed. 565.....	14
<i>Pufahl v. Estate of Parks</i> (1936) 299 U.S. 217.....	20
<i>Shively v. Bowlby</i> (1893) 152 U.S. 1, 38 L.ed. 331.....	14
<i>Shotkin v. Popenhager</i> (CA-5 1958) 255 F.2d 100....	2

TABLE OF CASES

v

Page

<i>Shulthis v. McDougal</i> (1912) 225 U.S. 561.....	10
<i>Slater v. Peyser</i> (CADC 1952) 200 F.2d 360.....	2
<i>State v. Quigley</i> (1958) 152 Wash. Dec. 192, 324 P.2d 827	22
<i>Stemmler v. McNiel</i> (C.C. E.D. N.C. 1900) 102 Fed. 660	12, 13
<i>Stone v. Wyoming Supreme Court</i> (CA-10 1956) 236 F.2d 275	3
<i>Teeters v. Henton</i> (D.C. Wyo. 1930) 43 F.2d 175.....	9
<i>United States v. Ashton</i> (1909) 170 Fed. 509 (appeal dismissed 220 U.S. 604).....	11, 15
<i>United States v. Bank of New York</i> (1936) 296 U.S. 463	21
<i>United States v. Schaefer Brewing Co.</i> (1958) 356 U.S. 227, 2 L.ed. 721.....	3
<i>United States v. Wissahickon Tool Works</i> (CA-2 1952) 200 F.2d 936.....	2
<i>Vaughn v. Warfield</i> (8th Cir. 1953) 207 F.(2d) 350..	12
<i>Walter v. Northeastern Railroad Co.</i> (1893) 147 U.S. 370, 13 S.Ct. 348.....	12

Statutes, Constitution, Treaties and Executive Orders

Enabling Act, 10 St. at L. 172.....	19 15
Executive Order Feb. 25, 1874.....	7
Treaty of 1855, 12 St. at L. 933.....	5, 21
28 U.S.C. 451, 62 St. at L. 907.....	8
28 U.S.C., Section 1331.....	7, 8, 9, 11
28 U.S.C., Section 1345.....	7, 8
28 U.S.C., Section 1349.....	8
28 U.S.C. Sec. 1446.....	21
Washington State Constitution, Article XVII.....	15

COURT RULES

Rule of Civil Procedure No. 58.....	2
Rule of Civil Procedure No. 73.....	2

1847
1848
1849
1850
1851
1852
1853
1854
1855
1856
1857
1858
1859
1860
1861
1862
1863
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1865
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1899
1900

United States Court of Appeals

For the Ninth Circuit

SKOKOMISH INDIAN TRIBE,	<i>Appellant,</i>	} No. 16008
vs.		
E. L. FRANCE, Trustee, <i>et al.</i> ,	<i>Appellees.</i>	

APPEAL FROM UNITED STATES DISTRICT COURT FOR
WESTERN DISTRICT OF WASHINGTON
SOUTHERN DIVISION

HONORABLE GEORGE H. BOLDT, *Judge*

BRIEF OF APPELLEES

Ernest Carlson, *et al.*; Simpson Logging Co., *et al.*;
Marcus Nalley, *et al.*; City of Tacoma; Chas. T. Wright,
et al.; E. L. France, *et al.*

MOTION TO DISMISS APPEAL

Motion

The appellees participating in this brief hereby move to dismiss the appeal of Skokomish Indian Tribe upon the ground and for the reason that the same has not been made nor perfected within the time or in the manner allowed by law or the applicable rules of court, in support of which motion appellants cite the following points and authorities.

Points and Authorities

The time limit on this appeal is thirty days from the entry of the order of dismissal (RCP 73). The time limit is jurisdictional. The final order was entered August 2, 1957 (Tr. 129-131) and the time was not enlarged by the later confirmatory order filed in December, 1957 (Tr. 132-134).

The notice of appeal filed January 6, 1958 (Tr. 134) was not within the thirty-day jurisdictional time limit under Rule 73 because the thirty days began to run August 2, 1957, when the court ordered the action dismissed (Tr. 129-131).

The time for filing notice of appeal under Rule 73 is jurisdictional.

Slater v. Peyser (CADC 1952) 200 F.2d 360;

Deena Products Co. v. United Brick Workers
(CA-6 1952) 195 F.2d 612, cert. den. 344
U.S. 822;

Shotkin v. Popenhager (CA-5 1958) 255 F.2d
100.

The record shows the final and appealable order was entered August 2, 1957 (Tr. 129-131) and more than the permissible time before the notice of appeal. Rule 58 in part specifies

“... When the court directs that a party recover only money or costs *or that all relief be denied*, the clerk shall enter judgment forthwith upon receipt by him of the direction ...”

Here the decision of August 2, 1957, was final and it was that “all relief be denied.”

A later or confirmatory order, such as that signed in December (Tr. 132), would not enlarge the time for appeal.

Erstling v. Southern Bell Co. (CA-5 1958) 255
F.2d 93;

United States v. Wissahickon Tool Works
(CA-2 1952) 200 F.2d 936, 938;

Napier v. Delaware R. Co. (CA-2 1955) 223
F.2d 28, 30-31;

Leonard v. Prince Line (CA-2 1946) 157 F.2d 987, 989;

Stone v. Wyoming Supreme Court (CA-10 1956) 236 F.2d 275.

All the foregoing cases recognize that there are sometimes confirmatory or duplicative orders entered and the holdings uniformly are that these do not enlarge the time for appeal. Contrasted with such cases is such a case as *United States v. Schaefer Brewing Co.* (1958) 356 U.S. 227, 2 L.ed. 721, in which the first order of the court, determining the right to relief in the case of an action for the recovery of money did not compute or describe the amount awarded and accordingly there had to be of necessity a later "final" order determinative of the proceedings. In such cases where a later order is required, such as in the case where a money judgment must be computed and awarded, the later order is held to be the appealable order. Such would not be true in the case now before the court.

ANSWERING BRIEF OF APPELLEES

Introduction — Nature of Case

This proceeding, commenced over ten years ago by the filing of appellant's complaint in the District Court, now reaches the Court of Appeals upon a challenge to the order dismissing the proceedings for want of jurisdiction in the District Court.

This is an action brought to quiet title to land in which the plaintiff must prevail solely upon the strength of its own title. This is not an action of trespass.

Appellant is responsible for the protracted character of this proceeding. Appellant's position and conduct is

so lacking in equity that it can hardly expect this court to strain to find justification for its position.

The complaint was filed in 1948 (Tr. 33). As service on the several defendants was made, they separately made appropriate motions to dismiss, principally during 1949 (Tr. 35-46). Judge Lindberg, in July, 1952, overruled then pending motions to dismiss (Tr. 47-53). The printed record does not reveal the answers then filed. However, in 1954, motions to dismiss for want of prosecution were submitted (Tr. 53-61) and an explanation of the delay in the litigation is reflected in the supporting affidavits (Tr. 54, 59).

While the motions to dismiss for want of prosecution were conditionally denied, a requirement for a pretrial order and a trial was fixed by an order of April 20, 1954 (Tr. 61-63).

The motions to dismiss for want of prosecution were again filed in 1956 (Tr. 72) and the delay further explained by affidavit and brief (Tr. 73, 75). These motions by appellees finally forced appellant to participate in and be a party to a pretrial order, entered October 1, 1956 (Tr. 80-115).

At the direction of the District Court, specific defendants' contentions against jurisdiction to hear the proceedings were re-argued and reconsidered before the court on June 12, 1957 (Tr. 117) and on August 2, 1957 (Tr. 129), on which latter date the court ordered the action dismissed (Tr. 131).

After a series of motions and orders postponing action in this appeal, a transcript was printed and became available in September, 1958, and appellant's brief

in November, 1958, virtually a decade after the initial filing of the action.

Pleadings

This case arises solely under a Pretrial Order (Tr. 80) which superseded all pleadings (Tr. 115).

It should be noted, however, that a substantial part of the Pretrial Order is not printed in the transcript. Pages 3 to 18, inclusive, and pages 19 to 36, inclusive, of the "Admitted Facts" in particular are not so printed.

It should be noted also that quotations from some publication, at pages 51 and following in the appendix to appellant's brief, are not a part of the record in this matter and not a part of the Pretrial Order.

Statement of the Case

Appellant's statement of the case obliges us to add the following clarification. As already noted, the action is not one of trespass.

Contrary to appellant's statement, the treaty (12 St. at L. 933) does not mention "shore lands in Hood Canal," let alone specify that the same were reserved for the exclusive use of Indians (nor the plaintiff corporation).

The treaty, contrary to appellant's statement, does not give the Indians (nor the plaintiff corporation) exclusive use of the "bed of Hood Canal" nor of any "tide lands touching upon or bordering the reservation." The treaty says nothing about such rights, exclusive or otherwise.

The treaty, contrary to appellant's statement, does

not grant to the Indians the "exclusive right to fish" at any particular location.

It is not a "fact" established in any way or admitted, as appellant gratuitously assumes throughout its brief, that these particular Indians sustained themselves to a great extent or to any extent whatever from shellfish from any part of the tide land strip in question. These are factual matters specifically, so reserved for trial in the Pretrial Order (Tr. 99, 97).

Amount of Tide Land Property Involved

The Skokomish Indian Reservation extends along several miles of the Skokomish River, passing through three full sections and parts of three others. The reservation also fronts on Hood Canal from the mouth of the river northward for several miles, extending the full width of Sections 26, 35 and 1 and parts of two other sections (Tr. 81).

Portions of the reservation have heretofore been lawfully allotted to Indians and alienated, such that by mesne conveyances those portions now are vested in the several defendant appellees or their successors. A narrow strip of tide lands over which the tide ebbs and flows, abutting upon each small upland tract, was conveyed by the State of Washington the defendant appellees or their predecessors in title (Pretrial Order pp. 3 to 36, not printed in transcript).

The several defendant appellees have no common interest other than the fact that they are being concurrently sued by appellant. They are cooperating in the preparation of this brief for reasons of economy.

Most of the parcels owned by defendant appellees are comparatively small, with narrow frontage on Hood Canal. For example, the Potlatch Beach tracts, in which several appellees are interested, are only forty to fifty feet in width (Pl. Ex. 15, Tr. 106). As to each of these parties, only that extent of the tide land strip submerged at each high tide is here involved.

The Skokomish Indian Reservation extends for miles along the Skokomish River and by way of that river the reservation has complete access to Hood Canal and the sea (Executive Order, Ex. 4, Tr. 105; Map, Ex. 7, Tr. 106).

This case involves, in the case of the individual defendant appellees, only a comparatively small segment of the tide land strip as it abuts their upland ownership, which long ago was lawfully alienated from Indian ownership.

Utility and Character of Tide Land Strip Not Involved

The rocky, gravelly, sandy or other character of the various segments of the tide land strip is not involved on this appeal, nor is the commercial character thereof, if any, nor any utility thereof for shellfish or scenery or any other conceivable purpose. Nor does this appeal involve whether the several segments are similar or dissimilar. These are not matters settled in the Pretrial Order (Tr. 80).

Jurisdiction

Appellant asserts jurisdiction under 28 U.S.C. Secs. 1331 and 1345. Appellees deny jurisdiction of this case exists in the District Court under the cited sections or at all.

Section 1345

Jurisdiction under 28 U.S.C. Section 1345, relating to actions by an agency or officer of the United States, was never claimed in any pleading before the District Court.

Plaintiff is not the United States nor an officer of the United States. Plaintiff is not an "agency" of the United States. The judicial code, 28 U.S.C. 451, 62 St. at L. 907, for the purposes of that code, expressly states that a corporation within the meaning of the term "agency" means a corporation in which the United States has a proprietary interest." Manifestly plaintiff cannot bring itself within the class of those entitled to invoke the jurisdiction of the District Court under Section 1345.

The decision in *Martinez v. Southern Ute Tribe* (CA-10 1957) 249 F.2d 915, 919, specifically holds incorporated tribes are not corporations pursuant to Section 1349 nor agencies of the United States as contemplated by Section 1345.

Section 1349

Also, jurisdiction may not be invoked by appellant on the theory that it is a corporation pursuant to an Act of Congress, since 28 U.S.C. Sec. 1349 specifies:

"The district courts shall not have jurisdiction of any civil action by or against any corporation upon the ground that it was incorporated by or under an Act of Congress, unless the United States is the owner of more than one-half of its capital stock."

Section 1331

The only section of the code under which appellant

has ever presumed to assert jurisdiction existed in the District Court in 28 U.S.C. Sec. 1331. Appellees, under appropriate chapter headings in this brief, will show the court

- (a) that no federal question exists in this matter and the case does not arise under the constitution, laws or treaties of the United States,
- (b) that the amount in controversy is not shown to exceed the sum or value of \$3,000 (but the action represents an unlawful attempt to join several separate lawsuits against numerous defendants for the purpose of aggregating the amounts).

That the action is brought by or on behalf of an Indian or an Indian tribe does not confer jurisdiction on the federal court. That an Indian tribe's right of possession is guaranteed by a treaty with the United States does not itself confer original jurisdiction on the federal court.

Deere v. St. Lawrence River Power Co. (CA-2 1929) 32 F.2d 550;

Teeters v. Henton (D.C. Wyo. 1930) 43 F.2d 175;

Phelps v. Hanson (CA-9 1947) 163 F.2d 973;

In re Celestine (D.C. Wash. 1902) 114 Fed. 551.

The foregoing cases hold no federal question was involved sufficient to give the District Court jurisdiction.

Existence of a Federal Question

No federal question actually exists under Section 1331 in this case. While the meaning of descriptive words in an executive order is involved, the meaning of

no law, constitution or treaty is involved in this action. The cited treaty does not deal directly with the tide lands in question. This litigation is concerned only with the extent of the legal description used in a later executive order. This is not a treaty question. It is not a federal question.

Shulthis v. McDougal (1912) 225 U.S. 561;

Crystal Springs Land & Water Co. v. City of Los Angeles (CC Cal. 1897) 82 Fed. 114, 117 affirmed 177 U.S. 169;

Joy v. City of St. Louis (1906) 201 U.S. 332;

Devine v. Los Angeles (1906) 202 U.S. 313, 333-4.

In *Shulthis v. McDougal*, *supra*, the court at page 569 says:

“A suit to enforce a right which takes its origin in the laws of the United States is not necessarily, or for that reason alone, one arising under those laws, for a suit does not so arise unless it really and substantially involves a dispute or controversy respecting the validity, construction or effect of such a law, upon the determination of which the result depends. This is especially so of a suit involving rights to land acquired under a law of the United States. If it were not, every suit to establish title to land in the central and western states would so arise, as all titles in those states are traceable back to those laws.”

In the *Crystal Springs case*, the court at page 117 says:

“Where the parties claim under Spanish or Mexican grants, confirmed and patented by the United States, and the controversy is only as to

what were the rights acquired by the parties respectively, or their predecessors in interest, under the Spanish or Mexican governments, it being conceded that the rights so acquired, whatever they may have been, were included in the confirmation and quitclaimed through the patent of the United States, federal jurisdiction does not exist . . .”

The case of *United States v. Ashton* (1909) 170 Fed. 509 (appeal dismissed 220 U.S. 604) conclusively shows want of jurisdiction in the District Court in a parallel case, where representatives of the Puyallup Indian Tribe sought to have the executive order defining the Puyallup Reservation interpreted to extend beyond the language of the executive order and to include abutting tide lands.

See also *Beck v. Johnson* (CC. Ky. 1909) 169 Fed. 154.

Complaint Fails to Show the Matter in Controversy Exceeds the Sum of \$3,000.00

Section 1331, Title 28, U.S.C.A., prior to its recent amendment, provided:

“The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of \$3,000.00, exclusive of interest and costs, and arises under the Constitution, laws or treaties of the United States.”

Plaintiff alleges that the matter in controversy exceeds the sum of \$3,000.00 but plaintiff does not contend nor allege that the matter in controversy exceeds the sum of \$3,000.00 as to each defendant (Tr. 4, 84).

This court does not have jurisdiction when several demands are made by one plaintiff against several de-

fendants when in each case the suit does not involve the jurisdictional amount. *Citizens Bank v. Cannon*, 164 U.S. 319; *Fishback v. Western Union Telegraph Co.*, 161 U.S. 96, 16 S.Ct. 506; *Fecheimer Bros. Co. v. Barnwasser* (6th Cir. 1945) 146 F.(2d) 974; *Vaughn v. Warfield* (8th Cir. 1953) 207 F.(2d) 350; *Calvert Distillers Corp. v. Rosen* (N.D. Ill. 1953) 115 F.Supp. 146.

The general rule is that jurisdiction is not conferred upon the federal court by joining claims against distinct and separate defendants, no one of which equals the jurisdictional amount. *Essmon v. Hood* (N.D. Texas 1930) 45 F.(2d) 881; *Hager v. Hanover Fire Ins. Co. of New York* (W.D. Missouri 1945) 64 F.Supp. 949; *Walter v. Northeastern Railroad Co.* (1893) 147 U.S. 370, 13 S.Ct. 348.

In *Stemmler v. McNiel* (C.C. E.D. N.C. 1900) 102 Fed. 660, the rules in reference to a quiet title action brought against multiple defendants were stated as follows, at page 661:

“... It is the rule of the Federal Courts that if there be several co-plaintiffs, each plaintiff must be competent to sue, and if there be several defendants, each defendant must be liable to be sued, or jurisdiction cannot be entertained. (Citing cases) So in this case, if each defendant has a separate and distinct claim of title to a parcel of the land which is below \$2,000.00 in value, he could not sue for it in the circuit court, and it would appear that he could not be sued for it in that court. . . .”

“... There can be no doubt that when the result of a suit, if successful, would be a separate decree against each defendant, the value of the dispute

between such defendant and the plaintiff must exceed \$2,000.00.”

In the instant case there can be no doubt, as in *Stemmler v. McNiel*, *supra*, that if plaintiff prevails in the action there would in effect be entered a separate decree as to each tract of tidelands owned by the various defendants. Defendants, in this action, each own separate small tracts of the uplands and the abutting tidelands along the Hood Canal in the State of Washington (Tr. 19-32). The separate tracts of tidelands vary in width from less than 80 feet to 4,138.2 feet (Tr. 19-32; also portion of Pretrial Order Tr. 80 not printed in transcript). The Potlatch Beach tracts are each less than fifty feet (Pl. Ex. 15, Tr. 106). Defendants do not own the tidelands as tenants in common or jointly (Tr. 19-32).

Likewise the defendants’ defenses are by and large separate and unrelated. Several of the defendants owning tidelands in the extreme north end of what is now the Skokomish Indian Reservation, on facts not related to most of the other defendants, assert as a defense that the tidelands in that area could never have been a part of the Indian Reservation by reason of the A. D. Fisher Donation claim (Tr. 87-89). At the same time the defendants owning tidelands several miles away in the southerly portion of the area in dispute defend on the basis that there is a dispute as to the boundary of the Skokomish Indian Reservation (Tr. 96). Likewise, a few of the defendants set up a prior action pending as a defense (Tr. 95-96). Each defendant, on facts peculiar to each defendant, has raised de-

fenses based on adverse possession and estoppel and upon the grounds that the conveyance of the uplands to the various defendants, at different times, from their several predecessors in title who were Indian allottees of the uplands carried with it title to the tidelands in question (Tr. 90-93). The only defenses common to the defendants and depending on like facts are that the court lacks jurisdiction, that plaintiff lacks the capacity to bring the action and the general denial of plaintiff's complaint (Tr. 86-96).

Based on the foregoing, we submit that plaintiff's action should be dismissed since the value of plaintiff's rights as against each defendant does not exceed \$3,000.00.

**Title Necessarily in Appellees or United States and
Not in Appellant**

Appellant does not plead and cannot claim or show a basis for title in itself to the tidelands in question. At best, that title must be either in appellees or the United States.

There is no question but that the tidelands and all lands under navigable waters were held by the United States in trust for the state to be formed:

Pollard v. Hagen (1845) 3 How. 212, 11 L.ed. 565;

Shively v. Bowlby (1893) 152 U.S. 1, 38 L.ed. 331 (particularly pp. 40, 48, 49, and 57 to 58);

Eisenbach v. Hatfield (1891) 2 Wash. 236, 26 Pac. 539.

The Enabling Act pursuant to which Washington

Territory was organized into a state (10 St. at L. 172) and the Washington State Constitution (Art. XVII) recognize the same principle.

There can be no question but that title to the tidelands described in this action is in the appellees as successors in interest to the State of Washington and beyond the power of Congress to vest in the appellant corporation (if indeed any Act of Congress can be found to any such effect), unless the Indian Reservation referred to by appellant clearly included the tidelands. The tidelands either vested in the state and hence in appellees or the tidelands were so fixed in the Indian reservation that it was not possible by the Enabling Act to vest the same in the state to be so formed. The tidelands are not in any treaty, order or record, pleaded by appellant stated to be in the reservation.

United States v. Ashton (1909) 170 Fed. 509.

Appellant can only rely on some contention that the tidelands are appurtenant to the upland portion of the reservation. But if that is appellant's reliance, then what of the fact that apparently portions of the reservation were platted into Indian lots or tracts and suitably allotted and disposed of such that the same have since been privately platted in accordance with recorded plats pleaded by appellant and known as Potlatch Beach Tracts and otherwise? (See portions of Pretrial Order, Tr. 80, not however printed in transcript.) Do not such allotted and sold portions of the reservation carry the same appurtenant title to the abutting tidelands, which appellant must be contending would have made such tidelands initially a part of the reservation?

Actually the reservation extends to high water mark. If it be appellant's contention that the reservation of the described uplands necessarily incorporated the abutting tidelands, then it must also be true that the subsequent disposition of the uplands to appellees carried to appellees the abutting tidelands.

Equity Case — Appellant Must Prevail, If At All, on Strength of Own Title

The appellant corporation in a quiet title suit and in an equity form must stand or fall on the strength of its own title and rights. Title, so far as can be known from any Acts of Congress or applicable law, would, even under appellant's contentions, be in the United States if not in the appellees, and would not, in any event, be in appellant. It is a well-known equity principle, applicable to all quiet title actions, that the appellant must succeed, if at all, upon the strength of its own title and not on account of any weakness in the title of the adversary.

Mitchell v. Cunningham (CA-9 1925) 8 F.2d 813.

Public Law 85-758, approved August 25, 1958, conveying to the Makah Indian Tribe specific lands in their reservation, illustrates the recognized necessity for such affirmative congressional action.

Nonjoinder of United States — Indispensable Party

Appellant sought to make the United States an involuntary party to this action (Tr. 125). The United States, acting through the Department of Justice, refused to become a party to the litigation (Tr. 126). The

District Court sustained the objection of the United States Attorney and hence this appeal is being prosecuted by a party having no title interest and no cause of action. Appellant asks this court to justify the continued prosecution of the action on the sole ground that it would be less burdensome on appellees to defend two such lawsuits than to deprive appellant of the right to prosecute the action.

The District Court did determine that title was clearly in the United States, rather than in appellant, if any of appellant's contentions were valid, and hence that the United States would be a necessary and indispensable party to the assertion of those claims against appellees. The only justification appellant urges for proceeding with the action without joinder of the United States is the relative convenience theory expressed by the Tenth Circuit in *Choctaw v. Seitz* (CA-10 1951) 193 F.2d 456.

In the last cited case the court at page 461 says:

"So it comes down to this: If we hold that the United States is an indispensable party, the Nations will be unable to assert their longstanding claim to the land; and if we hold that the United States is not an indispensable party, the defendants will run the risk of the burden and expense of defending two lawsuits, even though they succeed in obtaining a judgment in their favor in the instant action.

"We are of the opinion that the equities presented by the situation and the inconveniences that will result to the Nations, if they are denied the right to prosecute an action, and to the defendant, if the Nations are permitted to prosecute the ac-

tion without the joinder of the United States, weigh heavily in favor of the Nations.”

Thus is posed the question whether it is more important and equitable to adhere to the rule that a necessary and indispensable party should be made a party before subjecting parties to the burdens of litigation, particularly such as is inconclusive, or to permit a litigant to wage an action presently even though it cannot bind the real party in interest.

The Tenth Circuit repeatedly cites its decision. We do not believe it has been accepted elsewhere.

We have been unable to find any other decision which goes this far and we think it quite obvious that if the United States is not a party to this action, it would “leave the controversy in such a situation that its final determination would be inconsistent with equity and good conscience.”

The present litigation has been pending for some ten years. The appellant tribe was incorporated approximately ten years before that. During all of this period, of course, the appellants’ threatened action has imposed a serious cloud upon the title of the appellee’s lands. To protract the matter further and then to have a decree entered, which still would not settle any of the issues, must it seems be inconsistent with equity and good conscience.

This court has held, in effect, contrary to the *Seitz* decision on the question of the indispensability of the United States in an action involving the title to Indian lands. This it did in *Gerard v. U.S.*, 167 F.(2d) 951, an appeal from a decision of Judge Pray (D.C. Mont.)

cited as *Gerard v. Mercer*, 62 F.Supp. 28. The action was brought by two Blackfeet Indians seeking to quiet title to land on the Blackfeet Indian Reservation. The action was dismissed in the lower court on the ground that the United States was a necessary party and that the Indian plaintiffs had no power to joint it. In considering this issue Judge Pray said at page 30:

“That the United States is an indispensable party to this action is a proposition seriously advanced by defendants, supported by authorities that seem to afford some justification for the claim;”

* * *

“Without the presence of the United States in this action vital issues would remain undecided even though a judgment were entered herein for complainants and the whole subject would remain open for relitigation. The authorities cited would appear to be applicable to this contention and afford ample support of defendants’ objection.”

On appeal this court reversed Judge Pray, but on the ground that the United States had consented to be sued and should be made a party to the action. It is inherent in that decision that the United States was an indispensable party.

We believe the rule of the *Gerard* cases is sound and that it should be followed in the instant case instead of the *Seitz* rule.

Dismissal of the United States

Appellant’s brief, at page 2, refers to the United States having been originally named as a defendant. Pursuant to stipulation (Tr. 33) of February 17, 1949, between the plaintiff and the United States to the effect

that the United States had no interest in the action, an order (Tr. 36) was entered March 17, 1949 to the effect that the United States had no interest in any property described in the complaint, was not a necessary or proper party and was ordered dismissed.

That dismissal was without the concurrence, knowledge or participation of any of the defendant appellees.

Prior Pending Action Warranted Dismissal of This Action

A prior action to quiet the title to part of the lands which are the subject matter of this action had been previously instituted by the appellee, Charles T. Wright, in Mason County Superior Court Cause No. 5189, filed July 30, 1948. This senior state action named appellant, Skokomish Indian Tribe, as a party defendant and the following appellees herein were also named as parties defendant: Paul Hunter, Mary Hunter, City of Tacoma, State of Washington, Marcus Nalley and Frances Nalley (Tr. 95, Ex. 6, Tr. 110).

The issues and objectives in the prior state action and this action are similar in that the title, rights and location of the boundary lines of each of the last named parties' tidelands is sought to be determined and quieted in each action. By reason of its prior jurisdiction over the same subject matter and of the common defendants named above and over appellant herein, the Mason County Superior Court has retained and should retain jurisdiction of this controversy or suit so far as those parties are concerned.

Harkin v. Brundage (1928) 276 U.S. 36;

Pufahl v. Estate of Parks (1936) 299 U.S. 217.

It may be noted that procedural steps prescribed by federal law and pertinent Washington state statutes for removal of the senior state action to the United States District Court were not accomplished or even attempted. 28 U.S.C. Sec. 1446. The rule is well established that the federal district courts and the state courts have concurrent jurisdiction of all suits arising out of the United States Constitution and United States laws, save those actions as expressly restricted and reserved by Congress; that where concurrent jurisdiction does exist, a state court by taking prior jurisdiction as here excludes jurisdiction of the federal court on the same matters by the same parties.

Grubb v. Public Utilities (1930) 281 U.S. 470;
United States v. Bank of New York (1936)
 296 U.S. 463.

Aboriginal Rights

Appellant assumes throughout its brief that perhaps some right or privilege should be accorded it as an "aboriginal right," "original title," "separate sovereignty," or "reserved aboriginal right." These notions, we believe, are outside the record. The treaty relied upon (12 St. at L. 933) in Article I leaves no room for any such contentions, nor are these notions otherwise sustainable as law. See the following cases cited by appellant:

State v. Quigley (1958) 152 Wash. Dec. 192,
 324 P.2d 827;
Hynes v. Grimes Packing Co. (1949) 337 U.S.
 86, 93 L.ed. 1231.

Dilatoriness

The protracted course of this case, as related at the opening of this brief under the caption "Introduction—Nature of Case," confirms the absence of any equity in appellant's position and indeed suggests appellant's limited interest in the matter. Plaintiff's Exhibit 9 (Tr. 106) shows that this type of action is prosecuted under a contingent fee agreement and that appellant is not the sole party in interest.

It is not the position of appellees that the indifference of appellant and its lack of diligence in prosecuting the action must govern the disposition this court makes of this appeal, but that the circumstances warrant this court in being less concerned than otherwise it might with the gravity of barring an action on jurisdictional grounds.

Conclusion

Appellees accordingly contend the District Court correctly dismissed the action and that such disposition was justified:

1. Because jurisdiction was not shown in the district over any federal question.
2. Because the required jurisdictional amount was not shown.
3. Because of an unjustified misjoinder of numerous independent claims against numerous parties not having a common interest.
4. Because of the absence of an indispensable party.
5. Because of lack of right or title in plaintiff to the cause of action, if any.

6. Because of want of equity or right in plaintiff to pursue the protracted litigation.
7. Because a corporation chartered under congressional act is entitled to no immunities or indulgence not available to all other citizens, even though chartered to represent Indians.
8. Because a prior state court action remains pending concerning the same subject matter and many of the same parties.

Respectfully submitted,

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January 31, 1959.

United States Court of Appeals
For the Ninth Circuit

SKOKOMISH INDIAN TRIBE, *Appellant*,
vs.
E. L. FRANCE, TRUSTEE, *et al.*, *Appellees*.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR
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SOUTHERN DIVISION

BRIEF OF APPELLANT SKOKOMISH INDIAN TRIBE

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FILE

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PAUL P. O'BRIEN,



United States Court of Appeals
For the Ninth Circuit

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vs.

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INDEX

	<i>Page</i>
Opinion Below	1
Jurisdiction	1
Statement of Pleadings.....	1
Questions Presented	4
Specification of Errors.....	6
Argument	7
I. The District Court Should Have Found That the United States Is Not an Indispensable Party Insofar as This Action Is Concerned, But That It Is a Necessary Party.....	7
II. The State of Washington Consented to This Action Against It by Virtue of Its General Appearance and by Virtue of Its Consent Given in Article XXVI of the Washington State Constitution, Said Consent Being a Prerequisite to Statehood....	30
III. Appellants Are Not Foreclosed by a Prior Action Pending in the Superior Court of the State of Washington for Mason County Since the Issues There Presented Are Not Identical to the Issues Here Presented and the Proper Forum for the Cause Is the Federal Court.....	37
IV. The District Court Had Jurisdiction to Hear and Try the Issues and in Fact Is the Sole Forum Before Whom the Issues Could Be Presented.....	38
Summary of Argument and Conclusion.....	43
Appendix	45
Constitution of the United States, Article VI.....	45
12 United States Statutes at Large 933.....	45
48 United States Statutes at Large 984.....	49
Indians of the Pacific Northwest.....	51

TABLE OF CASES

<i>Alaska Pacific Fisheries v. United States</i> , 228 U.S. 78	39
<i>Anthony v. Veatch</i> , 220 P.(2d) 493 (Ore.) (1950).....	35
<i>Corrigan v. Brown</i> , 169 Fed. 477 (1907).....	17

	<i>Page</i>
<i>Cherokee Nation v. Georgia</i> , 5 Pet. 1, 8 L.Ed. 25 (1831)	30
<i>Choctaw and Chickasaw Nations v. Seitz</i> , 193 F.(2d) 456 (1951)	24, 26
<i>Clark v. Barnard</i> , 108 U.S. 436, 2 S.Ct. 878, 27 L.Ed. 780 (1882)	33
<i>Columbia Steel Co. v. State</i> , 34 Wn.(2d) 700, 209 P.(2d) 482 (1949).....	32
<i>Dunham v. Robertson</i> , 198 F.(2d) 316 (1952).....	28
<i>First National Bank of Holdenville v. Ickes</i> , 154 F. (2d) 851 (1946).....	24
<i>Gerard v. United States</i> , 167 F.(2d) 951 (1948).....	27
<i>Gibbs v. Oklahoma Turnpike Authority</i> , 285 P.(2d) 190 (Okla.) (1955).....	24
<i>Gila River Pima-Maricopa Indian Community v. United States</i> , 140 F.Supp. 776 (1956).....	20
<i>Great Northern Life Ins. Co. v. Read</i> , 322 U.S. 47, 88 L.Ed. 1121 (1944).....	33
<i>Hansen v. Hoffman</i> , 113 F.(2d) 780 (1940).....	27
<i>Hynes v. Grimes Packing Co.</i> , 337 U.S. 86, 93 L.Ed. 1231 (1949)	16
<i>Iron Crow v. Oglala Sioux Tribe</i> , 231 F.(2d) 89 (1956)	16
<i>Johnson v. M'Intosh</i> , 8 Wheat. 543, 5 L.Ed. 681.....	15
<i>Kuhn v. Yellow Transit Freight Lines</i> , 12 F.R.D. 252 (1952)	28
<i>Lewis v. Hansen</i> , 227 P.(2d) 70 (Mont.) (1951).....	29
<i>Lone Wolf v. Hitchcock</i> , 187 U.S. 565, 23 S.Ct. 221, 47 L.Ed. 306 (1903).....	35
<i>McCauley v. Makah</i> , 128 F.(2d) 867 (1942).....	23
<i>Minnesota v. United States</i> , 305 U.S. 282, 83 L.Ed. 235 (1939)	23, 26
<i>Moore v. United States</i> , 157 F.(2d) 760 (CCA 9) (1946)	19, 39, 40
<i>Neff v. Newcomer</i> , 307 P.(2d) 148 (Okla.) (1957)....	24
<i>Osage Tribe v. Ickes</i> , 45 F.Supp. 179 (1942).....	27
<i>Pape v. Armstrong</i> , 47 Wn.(2d) 480, 287 P.(2d) 1018 (1955)	32

<i>People ex rel. Bird v. Detroit etc. Ry. Co.</i> , 121 N.W. 814	31
<i>Pioneer Packing Co. v. Winslow</i> , 159 Wash. 655, 294 Pac. 557 (1930)	13
<i>Savoia Film v. Vanguard Films</i> , 10 F.R.D. 64 (1950)	28
<i>Seafert Bros. Co. v. United States</i> , 240 U.S. 194, 39 S.Ct. 203 (1919)	39
<i>Seminole Nation v. United States</i> , 316 U.S. 286, 86 L.Ed. 1480 (1942)	20
<i>Shade v. Downing</i> , 333 U.S. 586, 92 L.Ed. 894 (1948)	29
<i>Skelly Oil Co. v. Wickham</i> , 202 F.(2d) 442 (1953)....	27
<i>Squire v. Capoeman</i> , 351 U.S. 1, 76 S.Ct. 611, 100 L.Ed. 883 (1956)	21
<i>State v. Edwards</i> , 188 Wash. 467, 62 P.(2d) 1094 (1936)	14, 40
<i>State v. Quigley</i> , 152 Wash. Dec. 192 (1958)	15, 16
<i>State v. Satiacum</i> , 50 Wn.(2d) 513, 314 P.(2d) 400..	33
<i>State ex rel. Irvine v. District Court</i> , 239 P.(2d) 272 (Mont.) (1951)	35
<i>Toledo v. Pueblo de Jemez</i> , 119 F.Supp. 429 (1954)..	24
<i>Town of Okemah v. United States</i> , 140 F.(2d) 963....	26
<i>United States v. Brookfield Fisheries</i> , 24 F.Supp. 712 (1938)	35
<i>United States v. Candlaria</i> , 271 U.S. 432, 70 L.Ed. 1023 (1926)	24
<i>United States v. Hellard</i> , 322 U.S. 363, 88 L.Ed. 1326 (1944)	28
<i>United States v. Jacobs</i> , 113 F.Supp. 203 (1953)	16
<i>United States v. O'Brien</i> , 170 Fed. 508 (1904)	35
<i>United States v. Payne</i> , 264 U.S. 447, 68 L.Ed. 782 (1924)	21
<i>United States v. Romaine</i> , 255 Fed. 253	13
<i>United States v. State of Washington</i> , 233 F.(2d) 811 (1956)	23, 26
<i>United States v. Stotts</i> , 49 F.(2d) 619 (1930)	18
<i>Vermillion v. Spotted Elk</i> , 85 N.W.(2d) 432 (N.D.) (1957)	36

	<i>Page</i>
<i>West Coast Exploration Co. v. McKay</i> , 213 F.(2d) 582 (1954)	28
<i>Worcester v. Georgia</i> , 6 Pet. 515, 31 U.S. 515, 8 L.Ed. 483 (1833)	16

TEXTBOOKS

49 Am. Jur. Sec. 96.....	32
42 A.L.R. 1464, 1472.....	33
50 A.L.R. 1408.....	33
12 A.L.R.(2d) 29.....	38

STATUTES

Laws of Washington 1927, Ch. 216, §1 amending Laws of 1895, Ch. 95, §1.....	30
Laws of Washington 1927, Ch. 255, §194.....	30
Revised Code of Washington:	
R.C.W. 4.92.010	30, 72
R.C.W. 79.08.020	30, 32, 33
10 Stat. at Large, Ch. 90, p. 172.....	5, 8
10 Stat. at Large 1132.....	34
12 Stat. at Large 933.....	1, 5, 10, 19, 21, 33, 38, 45
12 Stat. at Large 951 (1855).....	39
25 Stat. at Large, Ch. 180, p. 180 (1889).....	9
48 Stat. at Large 984.....	6, 26, 49
49 Stat. at Large 378.....	6
52 Stat. at Large 937.....	37
25 U.S.C. §476.....	6
28 U.S.C.A. §56.....	27
28 U.S.C. §1331.....	1
28 U.S.C.A. §1360.....	40
248 U.S.C.A. §1441.....	37
1953 U.S.C.C. & A.N., Vol. 2, p. 2412.....	42
p. 2414.....	42

COURT RULES

Rule 19, Federal Rules of Civil Procedure.....	27
--	----

CONSTITUTIONS

Page

United States Constitution:

Art. I, §8, Cl. 3.....	8
Art. I, §10.....	37
Art. II, §2.....	34
Art. VI	34, 39, 45

Washington State Constitution:

Art. II, §26.....	30
Art. XXVI	10, 30, 33, 35

TREATIES

Treaty of 1855, United States-Skokomish Indians

12 Stat. at Large 933.....	1, 5, 10, 19, 21, 33, 38, 45
----------------------------	------------------------------

Treaty of 1855, United States-Yakima Indians

12 Stat. at Large 951.....	39
----------------------------	----

Types of Cases
HISTORY PRESENTATION

1. *Acute*

2. *Chronic*

3. *Subacute*

4. *Recurrent*

5. *Intermittent*

6. *Progressive*

7. *Stable*

8. *Remitting*

9. *Relapsing*

10. *Refractory*

11. *Resistant*

12. *Reversible*

13. *Irreversible*

14. *Self-limiting*

15. *Non-specific*

16. *Specific*

17. *Idiopathic*

18. *Symptomatic*

19. *Asymptomatic*

20. *Incidental*

21. *Unexplained*

22. *Unusual*

23. *Uncommon*

24. *Unlikely*

25. *Unlikely*

26. *Unlikely*

27. *Unlikely*

28. *Unlikely*

29. *Unlikely*

30. *Unlikely*

United States Court of Appeals

For the Ninth Circuit

SKOKOMISH INDIAN TRIBE,	<i>Appellant,</i>	} Docket No. 16008
vs.		
E. L. FRANCE, TRUSTEE, <i>et al.</i> ,	<i>Appellees.</i>	

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR
THE WESTERN DISTRICT OF WASHINGTON
SOUTHERN DIVISION

BRIEF OF APPELLANT SKOKOMISH INDIAN TRIBE

OPINION BELOW

The Court's oral decision in District Court Cause No. 1183 is found in the Transcript of Record commencing at page 129 and the Order of Dismissal is found in the Transcript of Record commencing at page 132.

JURISDICTION

Jurisdiction is based on U.S.C. Title 28, §1331, in that the amount in controversy exceeds \$3,000.00 and the interpretation of a treaty is involved [12 U.S. Statutes at Large, 933, See Appendix] and on U.S.C. Title 28, §1345, in that the proceeding is one commenced by an agency or officer of the United States expressly authorized to sue by Act of Congress.

STATEMENT OF PLEADINGS

The Complaint in this action was filed on the 3rd day of December, 1948, in the District Court of the United States for the Western District of Washington, Southern Division. On the 17th day of February, 1949, the

United States of America, originally named in the Complaint as a defendant, was dismissed upon Stipulation, that Stipulation being made upon the mutual understanding that Bonneville Power Administration had no interest in the land in question. The Order dismissing the United States pursuant to this Stipulation was entered on the 17th day of March, 1949, and subsequently Motions to dismiss were made by a number of the defendants, the grounds presented by these Motions being as follows:

1. There is another action pending.
2. The Complaint does not state facts sufficient to constitute a cause of action.
3. Laches.
4. Adverse possession.
5. The statute of limitations has run.
6. The Complaint fails to state a claim upon which relief can be granted.
7. The District Court lacks jurisdiction over the subject matter, and the person of the plaintiff, and the amount actually in controversy is not alleged to exceed \$3,000.
8. The plaintiff does not have capacity to sue, being an Indian Tribe not represented by the Government of the United States.

By Order of WILLIAM J. LINDBERG, District Judge, dated the 16th day of July, 1952, these various Motions to Dismiss were denied. Judge Lindberg's Memorandum Opinion and Order denying the Motions to Dismiss appear at page 47 of the Transcript of Record. Pre-trial conferences were then had and a pre-trial Order was entered on the 1st day of October, 1956,

signed by GEORGE H. BOLDT, District Judge [Transcript of Record, pages 80-116, inclusive].

Following the entry of the pre-trial Order, the District Court required the parties to submit additional briefs concerning the following contentions of the defendant:

1. There is a defect of parties plaintiff herein [Defendants' contention 24, Transcript of Record, page 93].
2. Court is without jurisdiction of the sovereign State of Washington, it not having consented to be sued in this Court nor waived its immunity from suit [Defendants' contention 25, Transcript of Record, page 93].
3. A prior action to quiet title to part of the lands which are the subject matter of the action has been previously instituted in a Superior Court of the State of Washington, which Superior Court has prior and exclusive jurisdiction [Defendants' contention 28, Transcript of Record, page 95].
4. The Court is without jurisdiction of this action and of the defendants or any of them, the value in controversy, exclusive of interest and costs, does not amount to \$3,000.00 as to any one of the defendants or his marital community [Defendants' contention 30, Transcript of Record, page 96].

Following the submission of briefs and further hearing on these contentions, the Court entertained a Motion of plaintiff to amend its Complaint for the purpose of adding the United States of America as an additional party plaintiff, which Motion the Court overruled. The District Court, on December 6, 1957, entered its formal Order dismissing the action, stating as follows:

“Ordered:

“1. The motion of plaintiff to add the United States of America as an additional party plaintiff be and the same is hereby denied.

“2. The motion of the State of Washington to be dismissed for want of consent to be sued is granted.

“3. As to the balance of the litigation, there is want of jurisdiction in the court to hear and try the issues and the action is hereby dismissed without prejudice.

“4. Exception is allowed the plaintiff as to each and all of the above rulings.”

QUESTIONS PRESENTED

1. Is there a defect of parties plaintiff herein?
2. Is the District Court without jurisdiction of the State of Washington?
3. Is the District Court without jurisdiction of the action since a prior action to quiet title to part of the lands which are the subject matter of this action has been previously instituted in the Superior Court of the State of Washington, for Mason County?
4. Does the District Court lack jurisdiction on the grounds that the value in controversy does not amount to \$3,000.00?
5. Has the State of Washington not consented to be sued in this matter?
6. Is the United States of America a necessary party?
7. Is the United States of America an indispensable party?
8. Is the United States of America not an indispensable party?
9. Does the District Court have jurisdiction to try the matter on its merits as to the balance of the litigation?

10. Does the District Court have jurisdiction of the subject matter and all of the parties to the action whether or not the State of Washington is a party defendant?

STATEMENT OF THE CASE

This is a trespass and quiet title action brought by the Skokomish Indian Tribe against all claimants to certain tide lands located at the head of Hood Canal in the State of Washington. The Territory of Washington was created by an Act of Congress in 1853 [10 U.S. Statutes at Large, Chapter 90, page 172]. Two years later, the United States entered into a Treaty with the S'Klallams Indians and with the Skokomish or Twanoh Tribe creating the Skokomish Indian Reservation [12 U.S. Statutes at Large, 933; Ratified and Proclaimed 1859]. The Treaty of 1855 specifically reserved to the tribe six sections of land at the head of Hood Canal and likewise reserved fishing rights at the usual and accustomed grounds. By the treaty the uplands, together with the shorelands in Hood Canal became and were reserved to the exclusive use, benefit and occupancy of the Skokomish Indian Tribe, together with the exclusive right for the use of the bed of Hood Canal and all tidelands touching upon or bordering the Reservation, along with the exclusive right to fish in all waters bordering upon the Reservation including tidal waters. These treaty rights were to be free from interference from the then Territory of Washington or any persons claiming under or by virtue of any title from the Territory of Washington (subsequently the State), subject only to the exclusive jurisdiction of the United States.

An Executive Order of President Grant in 1874 set aside the Skokomish Reservation by metes and bounds description, withdrawing said land from sale or other disposition. The Executive Order was in line with the intent and purpose of the Treaty to encourage the Skokomish Tribe to reside at one place on a Reservation set aside for their use and occupancy so selected as to be sufficient for the Tribe's wants and needs that then existed and would continue to exist in the future. Thus the Treaty took into consideration the fact that these Indians sustained themselves to a great extent from the tidal waters flowing and ebbing in Hood Canal where could be found an excellent source of many kinds of shellfish. In 1889 Washington became a State and adopted its Constitution. Following statehood, the State of Washington wrongfully asserted ownership and retained the same unto itself or granted by lease, conveyance or otherwise, to defendants named herein or their predecessors claims of right to the tide lands which form a part of the land reserved for the tribe by treaty. The Skokomish Indian Tribe incorporated under the Act of Congress of June 18, 1934 [48 U.S. Statutes at Large, 984; 25 U.S.C. 476], as amended by the Act of June 15, 1935 [49 U.S. Statutes at Large, 378], and has brought this action in its corporate right.

SPECIFICATION OF ERRORS

Appellants rely upon the following errors of the Court below:

- “1. The Court erred in denying plaintiff's motion to make the United States a party.
- “2. The Court erred in granting the motion of the

State of Washington to be dismissed for want of consent to be sued.

- “3. The Court erred in ruling that as to the balance of the litigation there was want of jurisdiction in the Court to hear and try the issue.
- “4. The Court erred in ruling that the United States is an indispensable party in this proceeding, or in the alternative, in refusing to rule that the United States is not an indispensable party.
- “5. The Court erred in refusing to rule that it had jurisdiction of the subject matter and of all the parties to the action save the State of Washington and therefore had jurisdiction to proceed with the trial of the action as to such other parties despite the dismissal of the State of Washington.
- “6. The Court erred in dismissing the action of the plaintiff.”

ARGUMENT

I.

The District Court Should Have Found that the United States Is Not an Indispensable Party Insofar as This Action Is Concerned, but That It Is a Necessary Party

The first and fourth points set forth in appellants' specification of errors concern the United States as a party to the proceedings. These two points are so completely interwoven that a joint discussion of them not only will be more expeditious but will be cohesive and more clearly understood.

To understand the relationship of the United States to the Skokomish Indian Tribe and to comprehend this problem of the position that the United States should

play in this action, it is essential to approach the solution with certain well-founded concepts of Indian Law in mind.

The rights of an Indian Tribe in land occupied by it within the boundaries of the United States are absolute rights which are encumbered only by the restrictions put upon them since the coming of the White man. This aboriginal right of the Indian Tribes is indeed a higher title than a fee simple title free and clear of all encumbrances since the Indians enjoy many freedoms and immunities which are not available to White citizens. Encompassing and fencing in these free aboriginal rights are State Constitutions and United States Treaties which encircle the untouched islands of Indian right as a dammed stream encircles high ground but leaves it dry. It is essential to view the problem of the United States as a party to this action affecting Indian land in the light of this basic premise.

In Article I, Sec. 8, Clause 3, of the Constitution of the United States, Congress was given the power to regulate commerce with foreign nations, and among the several states, and with the Indian Tribes. In the preamble of the Organic Act [10 U.S. Statutes at Large, Chap. 90, Page 172], creating the Territorial Government of Washington, which was approved March 2, 1853, we find:

“PROVIDED, That nothing in this act contained shall be construed to affect the authority of the government of the United States to make any regulation respecting the Indians of said Territory, their lands, property, or other rights, by treaty, law, or otherwise, which it would have been com-

petent to the government to make if this act had never been passed . . .”

It will be noted that the philosophy of the Organic Act recognizes that the creation of the Territory in no way affected the rights of the Indians living within that Territory, who remain free to deal directly with the Federal Government without being subject in any degree to the jurisdiction of the newly-created Territory insofar as their lands were concerned.

The Enabling Act [25 U.S. Statutes at Large, Chap. 180, Page 676, 1889], enabling the people of North Dakota, South Dakota, Montana and Washington to form Constitutions and State Governments and to be admitted into the Union on equal footing with the original states imposed the following restriction as a condition of statehood:

“Second. That the people inhabiting said proposed States do agree and declare that they forever disclaim all right and title to the unappropriated public lands lying within the boundaries thereof, and to all lands lying within said limits owned or held by any Indian or Indian Tribes; and that until the title thereto shall have been extinguished by the United States, the same shall be and remain subject to the disposition of the United States, and said Indian lands shall remain under the absolute jurisdiction and control of the Congress of the United States . . . that no taxes shall be imposed by the States on lands or property therein belonging to or which may hereafter be purchased by the United States or reserved for its use. But nothing herein, or in the ordinances herein provided for, shall preclude the said States from taxing as other lands are taxed any lands owned or held by any In-

dian who has severed his tribal relations, and has obtained from the United States or from any person a title thereto by patent or other grant, save and except such lands as have been or may be granted to any Indian or Indians under any act of Congress containing a provision exempting the lands thus granted from taxation; but said ordinances shall provide that all such lands shall be exempt from taxation by said States so long and to such extent as such act of Congress may prescribe.”

As a part of the Constitution of the State of Washington, adopted by the people of Washington on May 14, 1889, the State compacted with the Federal Government in line with the Enabling Act by adopting the quoted provision of the Enabling Act verbatim in Article XXVI, Sec. Second, of the Washington State Constitution. Thus we find as a part of the original sacred contract by which Washington became a State, that the State acknowledges that it and its people must forever keep hands off Indian lands and acknowledges that said Indian lands are under the absolute jurisdiction and control of the Federal Government. The title to Indian lands remains subject to the disposition of the United States, which is the only entity which can extinguish title and the United States retains jurisdiction until valid conveyance of title.

Previous to Statehood, the United States had entered into the Treaty with the Skokomish Indians on the 26th of January, 1855. Articles III and IV of that Treaty entered into between the United States and the sovereign tribe read as follows:

“Article 3. The said tribes and bands agree to remove to and settle upon the said reservation

within one year after the ratification of this treaty, or sooner if the means are furnished them. In the meantime, it shall be lawful for them to reside upon any lands not in the actual claim or occupation of citizens of the United States, and upon any land claimed or occupied, if with the permission of the owner.

“Article 4. The right of taking fish at usual and accustomed grounds and stations is further secured to said Indians, in common with all citizens of the United States; and of erecting temporary houses for the purpose of curing; together with the privilege of hunting and gathering roots and berries on open and unclaimed lands. PROVIDED, however, that they shall not take shellfish from any beds staked or cultivated by citizens.”

By Executive Order signed February 25, 1874, the boundaries of the Skokomish Reservation were further delineated. That Executive Order is as follows:

“SKOKOMISH RESERVATION

“Executive Mansion, February 25, 1874.

“It is hereby ordered that there be withdrawn from sale or other disposition and set apart for the use of the S’Kallam Indians the following tract or country on Hood’s Canal, in Washington Territory, inclusive of the six sections situated at the head of Hood’s Canal, reserved by treaty with said Indians January 26, 1855 (Stat. L. vol. 12, p. 934), described and bounded as follows: Beginning at the mouth of the Skokomish River; thence up said river to a point intersected by the section line between sections 15 and 16 of township 21 north, in range 4 west; thence north on said line to a corner common to sections 27, 28, 33, and 34 of township 22 north, range 4 west; thence due east to the south-

west corner of the southeast quarter of the southeast quarter of section 27, the same being the southwest corner of A. D. Fisher's claim, thence with said claim north to the northwest corner of the northeast quarter of the southeast quarter of said section 27; thence east to the section line between sections 26 and 27; thence east to Hood's Canal; thence southerly and easterly along said Hood's Canal to the place of beginning."

"U. S. GRANT."

The Washington State Supreme Court has often acknowledged the separate status of Indian Reservation Land as that status is circumscribed by the United States Constitution, Treaty, the Organic and Enabling Acts and the Washington State Constitution. The concept flowing from these documents which sets apart reservation land is important in understanding the part that the United States plays with relation to the Skokomish Tribe and the Reservation granted it by treaty. Under those documents, the State of Washington has no power, authority or jurisdiction over the land and cannot be said to be an intermediary between the tribe and the Federal Government insofar as the lands are concerned. No decision can be made concerning the role that the United States should play now that a conflict has arisen between the Skokomish Tribe and the State of Washington without recalling that the State has conceded the absolute power of the Federal Government to exercise a paternalistic jurisdiction and authority over these lands. Such a paternalistic authority carries with it the correlative duty to protect the Skokomish Tribe from a breach of the sacred contract made between the State and the Nation for the protection of a beneficiary

Indian Tribe. We submit that in light of this duty, the United States cannot repudiate the Skokomish Indian Tribe by refusing to be a party to this action.

The Washington Supreme Court has long recognized the primary paternalistic relationship which the United States bears to the Indian Tribes which have been set apart on the Reservations by treaty. *Pioneer Packing Co. v. Winslow*, 159 Wash. 655, 294 Pac. 557 (1930), involved the right of the Quinault Indian Tribe to sell fish in the Quinault River in interstate commerce, unrestricted by the game laws of the State of Washington. The Washington Court stated that Federal Courts had often held that where there is a ceding and reservation under a treaty of the kind there and here involved, the Indians hold the lands subsequently designated in the Executive Order in the same title and with the same right as they previously owned the entire area ceded. In the *Pioneer Packing* case, the Washington Court cited *United States v. Romaine*, 255 Fed. 253, which stated that under a history similar to the one there, and here involved, the Indians held under their original title. The Court said:

“ ‘It is not to be supposed that in making the treaty the government intended to take from the Indians any of the rights they had theretofore enjoyed . . . In the Enabling Act, by which the territory of Washington was admitted into the Union (Act Feb. 22, 1889, c. 180 §4, 25 Stat. 676), the people of the newly created state were required to agree and declare that they forever disclaim all right and title — “to the unappropriated public lands lying within the boundaries thereof, and to all lands lying within said limits owned or held by

any Indian or Indian tribes; and that until the title thereto shall have been extinguished by the United States, the same shall be and remain subject to the disposition of the United States and said Indian lands shall remain under the absolute jurisdiction and control of the Congress of the United States." ' ' "

In *State v. Edwards*, 188 Wash. 467, 62 P.(2d) 1094 (1936), two Indians were charged with trapping fish outside of their reservation in violation of State law. The question presented was whether or not the traps were within the Indian Reservation. The treaty with that tribe was likewise entered into in 1855 and one of the boundaries of the reservation therein involved was fixed as the "low water mark." The Court held that since this term was used in a treaty with the Indians it would not be construed in its technical meaning but in such way as the Indians themselves would understand it. In the *Edwards* case the Washington court said:

"The Indian tribes within the limits of the United States are not foreign nations; though distinct political communities, they are in a dependent condition; and Chief Justice Marshall's description, that 'they are in a state of pupillage,' and 'their relation to the United States resembles that of a ward to his guardian,' has become more and more appropriate as they have grown less powerful and more dependent. . . . "

"In construing any treaty between the United States and an Indian tribe, it must always (as was pointed out by the counsel for the appellees) be borne in mind that the negotiations for the treaty are conducted, on the part of the United States, an enlightened and powerful nation, by representa-

tives skilled in diplomacy, masters of a written language, understanding the modes and forms of creating the various technical estates known to their law, and assisted by an interpreter employed by themselves; that the treaty is drawn up by them and in their own language; that the Indians, on the other hand, are a weak and dependent people, who have no written language and are wholly unfamiliar with all the forms of legal expression, and whose only knowledge of the terms in which the treaty is framed is that imparted to them by the interpreter employed by the United States; and that the treaty must therefore be construed, not according to the technical meaning of its words to learned lawyers, but in the sense in which they would naturally be understood by the Indians. *Worcester v. Georgia*, 6 Pet. 515; *The Kansas Indians*, 5 Wall. 737, 760; *Choctaw Nation v. United States*, 119 U.S. 1, 27, 28. *Jones v. Meehan*, 175 U.S. 1, 20 S.Ct. 1."

The Federal Government itself may restrict or limit Indian title but it is the sole entity which may do so. The Federal Government is the Guardian of the Independent Sovereignties which the Indian Reservations are, and neither a State nor its citizens in any manner may transfer or encumber Indian land. As stated in the recent case of *State v. Quigley*, 152 Wash. Dec. 192 (1958), quoting from the words of Chief Justice Marshall in *Johnson v. M'Intosh*, 8 Wheat. 543, 5 L.Ed. 681,

" . . . the exclusive right of the United States to extinguish Indian title has never been doubted. . . . "

The State of Washington has here endeavored to extinguish Indian title by conveyance and by asserting

an ownership of it. When such a situation arises, we fail to see how the United States can claim that it is not a proper party to an action brought by the Indians to protect their lands when the United States has given its solemn promise to protect said land and set it apart in its treaty with the tribe and carried forth that promise by requiring the State of Washington to acknowledge Indian right in its Constitution. See *Worcester v. Georgia*, 6 Pet. 515, 31 U.S. 515, 8 L.Ed. 483 (1833), and *Iron Crow v. Oglala Sioux Tribe*, 231 F.(2d) 89 (1956).

Member states of the union have no right to the lands reserved to the Indians. *U. S. v. Jacobs*, 113 F.Supp. 203 (1953). Indian Nations are separate sovereignties whose lands by the happenstance of geography are within the boundaries of states. *Iron Crow v. Oglala Sioux Tribe*, *supra*. When the reservation of Indian lands reserved to these separate sovereignties who are dependent upon the United States are encroached upon by a reckless state government, the United States owes a duty to protect the weak dependent Indian Nation. Indeed this duty arises from the contractual obligation created by treaty and from the legal and moral obligation of a great power to a subjugated one. The United States is the sole governmental unit which may extinguish Indian title [*State v. Quigley*, 152 Wash. Dec. 192 (1958); *Hyres v. Grimes Packing Co.*, 337 U.S. 86, 93 L.Ed. 1231 (1949)] and indeed, when a state chooses to infringe upon that right of the Federal Government, it ill behooves the Federal Government not to protect its right, the right given to it in good faith by subjugated people.

To perform its responsibility, the United States must be a party to this action.

This argument is bolstered by the decision of the District Court for the Western District of Washington in *Corrigan v. Brown*, 169 Fed. 477 (1907). That case concerned itself with the interpretation of a treaty entered into in 1855 creating the Swinomish Reservation. In passing, we note how many of these treaties were entered into in the same decade by the Federal Government with the Indians of the Puget Sound country. It stands to reason that the interpretation of these treaties should be uniform, the relationship between the Government and the Indians should be the same and the responsibility of the United States towards the tribes should be as imperative in one situation as another. In the *Corrigan* case the District Court was faced with the interpretation of a treaty as to whether or not tidelands there in dispute were part and parcel of the land reserved to the Indians. All the merits of the question presented in that case are the same as those presented here. Resting its decision upon the disclaimer found in the compact, which is a condition of statehood and admission into the Union and which is found in the Washington State Constitution, the court said:

“ . . . The disclaimer of the state contained in the Constitution adopted by the people applies to all lands within the boundaries of Indian reservations to which the primary right of occupancy of the Indians has not been extinguished. By the treaty made with the Indians in 1855, land was reserved for the exclusive use of the tribe or band of Indians to which the defendants belong, and by the President's order made in 1873 the boundaries

of the reservation were precisely established, so that the reservation includes all the land above the line of low water. Therefore, beyond any question, this tract of land is entirely within the boundaries of a reservation to which the rights of the Indians have never been extinguished, and it is comprehended by the disclaimer in the state Constitution . . . ”

The United States accepted its responsibility as guardian of the Indian Tribes, appearing through the Attorney General in *United States v. Stotts*, 49 F.(2d) 619 (1930). That case likewise dealt with tidelands which were a part of an Indian Reservation and reiterated that the Indians' right of occupancy is not predicated upon a grant of the United States but is a reserved aboriginal right which the Indians inherently held in the land segregated and withheld from the territory ceded by the Indians under treaty. Likewise, the case reiterates that the Enabling Act allowing the creation of the State of Washington expressly disclaims any interest in Indian lands. Here, as in case after case, the philosophy is expressed that Indian treaties are to be liberally construed, to the end that the Indians will retain the benefits conferred by their treaties at the time of each treaty's execution, and in so construing the treaty, it is recognized that the Indians were dependent upon the tidelands along the extremities of their Reservations and that these tidelands must, of necessity, be part and parcel of the impregnable Indian right. To hold otherwise would be to derogate from that purpose for which the land was originally reserved, the creation of a place where the Indian could continue to make a living

in the environment to which he was accustomed and adapted.

In interpreting the treaty, we are bound by the rule that we must approach the problem as a matter of exclusion rather than inclusion with the burden resting on him who would exclude, since the presumption must be that the land is included in the Reservation. The same premise follows where the representation and support of the United States is concerned. It should be presumed that the United States would be a proper party plaintiff, assuming its fiduciary duty to protect its wards rather than neglecting that duty and assuming its duty to uphold the high contract, the Treaty of 1855, against the state that would impair the performance of that obligation. We are asking the United States to assume its duty and appear as a party plaintiff.

This duty to join with the Indian in protecting his rights to Reservation lands is obvious when we consider that the purpose of the Reservation was to provide for the Indian an area upon which he could live and from which he could gain his sustenance. The merits of this case deal with whether or not certain shellfish yielding tidelands are part of the Reservation set aside for the Skokomish Indians. By the Treaty of 1855 the Skokomish relinquished their rights and claims to land outside the Reservation. In return therefor they achieved an uncontested right to an area which would furnish them food. The passage of over a hundred years since the execution of that treaty does not absolve the United States of its duty to uphold it. As was said in *Moore v. United States*, 157 F.(2d) 760 [CCA 9] (1946):

“The Indians could not sustain themselves from the use of the upland alone. The use of the adjacent fishing grounds was completely essential. Without this the colony could not prosper in that location. The Indians naturally looked on the fishing grounds as part of the islands and proceeded on that theory in soliciting the reservation . . . ”

The Skokomish likewise looked to the shellfish of Hood Canal from which to gain their sustenance and the Skokomish look to the United States to assist in preserving their means of livelihood by joining with them as a party to this action.

That a guardian should appear on behalf of its ward in an action involving the property of the ward is a maxim which does not require citation. The finding that the legal relationship of guardian and ward exists between a particular Indian Tribe and the United States depends upon the express provisions of the treaty, executive order or statute under which a claim arises. *Gila River Pima-Maricopa Indian Community v. United States*, 140 F.Supp. 776 (1956). The court said in *Seminole Nation v. United States*, 316 U.S. 286, 86 L.Ed. 1480 (1942):

“Furthermore, this court has recognized the distinctive obligation of trust incumbent upon the government in its dealings with these dependent and sometimes exploited people [citing cases]. In carrying out its treaty obligations with the Indian tribes the government is something more than a mere contracting party. Under a humane and self-imposed policy which has found expression in many acts of Congress and numerous decisions of this court, it has charged itself with moral obligations of the highest responsibility and trust. Its

conduct, as disclosed in the acts of those who represent it in dealings with the Indians, should therefore be judged by the most exacting fiduciary standards.”

Looking then at the treaty between the United States and the Skokomish Indians entered into in 1855 and found in 12 Statutes at Large 933 (see Appendix) to ascertain the relationship between the United States and the Skokomish, we find these words:

“Said tribes and bands acknowledge their dependence on the Government of the United States.”

We do not feel that the United States can wash its hands of this affair and turn its back on the Skokomish Tribe which needs its help and support. For the United States to do so is for it to neglect its duty and moral obligation as guardian in an unconscionable manner. As was said in *United States v. Payne*, 264 U.S. 447, 68 L.Ed. 782 (1924):

“They are an unlettered people, unskilled in the use of language . . . with regard to whom the United States occupies the position and assumes the responsibilities of virtual guardianship, bound by every moral and equitable consideration to discharge its trust with good faith and fairness.”

In the very recent case of *Squire v. Capoeman*, 351 U.S. 1, 76 S.Ct. 611, 100 L.Ed. 883 (1956), Chief Justice Warren stated the question to be whether the proceeds of sale of standing timber on lands of an Indian Reservation could be subject to capital gains tax consistently with the applicable treaty and the government's role as the Indians' trustee and guardian. The Federal Gov-

ernment there urged the Supreme Court to disregard the treaty and the guardian-ward relationship between the United States and the Indians. In finding that the Internal Revenue Acts must yield to the treaty the court quoted from an opinion of the Attorney General which stated in part:

“[U]nable, by implication, to impute to Congress under the broad language of our Internal Revenue Acts an intent to impose a tax for the benefit of the Federal Government on income derived from the restricted property of these wards of the nation; property the management and control of which rests largely in the hands of officers of the Government charged by law with the responsibility and duty of protecting the interests and welfare of these dependent people. In other words, it is not lightly to be assumed that Congress intended to tax the ward for the benefit of the guardian.”

Therefore, the United States owes a duty to the Skomish Tribe to preserve and uphold the treaty and it owes a duty to the dependent tribe of guardianship of the tribe's reserved rights.

What then is the position of the United States? Is it a necessary party in this action, an indispensable party, or neither of these and completely unnecessary as a party at all? The answer to that question lies in the premises we have set forth above and the relationship of the United States to the lands here involved.

This is an action by an incorporated Indian tribe to quiet title to lands reserved free and clear of the interests of other governments when the larger parts of the aboriginal rights to its more extensive area were ceded

to the United States by treaty. This, therefore, is not an action concerning the United States in a proprietary capacity, but one which concerns it in its governmental function and relationship with this Indian Tribe. In this action brought by the Skokomish Indians, the Tribe is not endeavoring to alienate or encumber its Reservation land in any manner, but to remove conflicting claims to that land. Under these facts, the United States is not an indispensable party but is a necessary party.

In *Minnesota v. United States*, 305 U.S. 282, 83 L.Ed. 235 (1939), condemnation by the State of Minnesota of reserved Indian lands was involved. Justice Brandeis, speaking for the court, held that the United States was an indispensable party defendant to the condemnation proceeding since it involved property in which the United States had an interest and therefore was a suit directly against the United States. This holding was based upon the finding that the United States held the fee to these allotted lands *in trust* for the Indians. The Skokomish Indian Tribe was incorporated pursuant to legislative authority and has power to sue in its own name and in its own behalf, so the United States is *not* an indispensable party but this does not mean that the United States is not necessary. *McCauley v. Makah Indian Tribe*, 128 F.(2d) 867 (1942).

The United States has muniments of title to the Skokomish Reservation only through the Treaty and is a guardian for the tribe and not a trustee of the land itself. *United States v. State of Washington*, 233 F.(2d) 811 (1956), involved a legal trust interest in certain Indian lands themselves and not a fiduciary relationship

of guardian and ward. There the Government was found to be the real party in interest in prosecuting an action to quiet title to the land in question for the benefit of individual Indian wards, since the individual Indian wards founded their claim upon a trust patent, the United States being trustee. See also *First National Bank of Holdenville v. Ickes*, 154 F.(2d) 851 (1946); *Neff v. Newcomer*, 307 P.(2d) 148 [Okla.] (1957); *Gibbs v. Oklahoma Turnpike Authority*, 285 P.(2d) 190 [Okla.] (1955).

The mere fact that the United States may be guardian for an Indian tribe does not make it trustee of its lands. The title to Indian land may remain in the Indian tribe, as with the Skokomish, and spring from the treaty concerning the Reservation although the power of the tribe is subject to congressional control. *Toledo v. Pueblo de Jemez*, 119 F.Supp. 429 (1954). This congressional power over the tribe itself does not necessarily mean that the United States is trustee of the land of the Indian tribe, but only that it is guardian of the tribe itself.

The distinction is spelled out in *United States v. Candelaria*, 271 U.S. 432, 70 L.Ed. 1023 (1926), and *Choc-taw and Chickasaw Nations v. Seitz*, 193 F.(2d) 456 (1951). The *Candelaria* case presented the question whether Indians in New Mexico were in such status of tutelage as to their land that the United States, as guardian, was not barred by a judgment in a suit involving title to the lands. Answering this query, the court stated that the Indians were wards holding their lands subject to the restriction that said land could not be alienated without the consent of the United States.

Therefore, a judgment or decree which would operate to transfer the lands from the Indians, where the United States had not authorized or appeared in the suit, would infringe the restriction and the United States would not be barred by the action. The Skokomish Indian Tribe holds its Reservation land in the same manner and in the event that the United States is not made a party to this case, certainly the United States will not be barred by any result of the action. The *Seitz* case was an action by the Indian Nations to recover possession of, and establish title to, certain lands. Individual defendants had filed a motion to dismiss the Indian complaint on the ground of the non-joinder of the United States as a party. The court stated that by reason of its guardianship and its governmental interest in the lands, the United States would not be bound by a judgment in the action unless it became a party thereto, but that the United States was not an indispensable party. It defined indispensable party as follows:

“An indispensable party is one who has such an interest in the subject matter of the controversy that a final decree cannot be rendered between the other parties to the suit without radically and injuriously affecting his interest, or without leaving the controversy in such a situation that its final determination may be inconsistent with equity and good conscience.”

The court pointed out in view of the guardianship of the United States, that it would not be bound by a judgment in which it was not joined, but held that the Indian tribes had been given scope to prosecute or defend actions with respect to their lands on their own behalf so completely that the United States was not an indispen-

sable party and the Indian tribes could maintain such action on their own. When Congress granted to the Indian tribes the power to incorporate, by virtue of the Act of 1934 (48 U.S. Statutes at Large 984) it gave to the Indian tribes incorporating under that act the power to protect their rights whether or not the United States chose to assume its responsibility. So the Indian tribes are not at the whim of the United States as to whether or not they may protect their rights in Federal Court and they may come forth and do so alone. However, though the United States may be dispensed with initially as a party plaintiff, this does not mean that they are not necessary to the action. The *Seitz* case distinguished *Minnesota v. United States, supra*, and *Town of Oke-mah v. United States*, 140 F.(2d) 963, stating that those were actions to condemn lands belonging to Indians, the title to which was held *in trust* by the United States; that the effect of a judgment in those actions would have been an alienation of the land. It was pointed out that the effect of a judgment in favor of the Indians in the *Seitz* case would establish the title of the Indians to the land and give them possession and use thereof. Concluding, the court stated, in part, as follows:

“ . . . If we hold that the United States is an indispensable party, the Nations will be unable to assert their longstanding claim to the land; and if we hold that the United States is not an indispensable party, the defendants will run the risk of the burden and expense of defending two lawsuits, even though they succeed in obtaining a judgment in their favor in the instant action.

“We are of the opinion that the equities presented by the situation and the inconveniences that

will result to the Nations, if they are denied the right to prosecute an action, and to the defendant, if the Nations are permitted to prosecute the action without the joinder of the United States, weigh heavily in favor of the Nations.”

See also *Skelly Oil Co. v. Wickham*, 202 F.(2d) 442 (1953); *Gerard v. United States*, 167 F.(2d) 951 (1948); *Hansen v. Hoffman*, 113 F.(2d) 780 (1940), and *Osage Tribe v. Ickes*, 45 F.Supp. 179 (1942). This is precisely the situation here. To hold that the United States was an indispensable party would be to leave the Skokomish Indian Tribe at the mercy of the State of Washington and its citizens.

If the United States is not an indispensable party, is it a necessary party and therefore one that should have been joined in the action? Rule 19, Federal Rules of Civil Procedure, 28 U.S.C.A. 56, reads in part as follows:

“(a) *Necessary Joinder*. Subject to the provisions of Rule 23 and of subdivision (b) of this rule, persons having a joint interest shall be made parties and be joined on the same side as plaintiffs or defendants. When a person who should join as a plaintiff refuses to do so, he may be made a defendant or, in proper cases an involuntary plaintiff.

“(b) *Effect of Failure to Join*. When persons who are not indispensable, but who ought to be parties if complete relief is to be accorded between those already parties, have not been made parties and are subject to the jurisdiction of the court as to both service of process and venue and can be made parties without depriving the court of jurisdiction of the parties before it, the court shall order

them summoned to appear in the action. The court in its discretion may proceed in the action without making such persons parties, if its jurisdiction over them as to either service of process or venue can be acquired only by their consent or voluntary appearance or if, though they are subject to its jurisdiction, their joinder would deprive the court of jurisdiction of the parties before it; but the judgment rendered therein does not affect the rights or liabilities of absent persons.”

We call attention to the statement concerning the joinder of the United States as a necessary party made by Judge Boldt in his oral decision (Transcript of Record Page 121).

A necessary party is a party that will be affected by the judgment and against which, in fact, a judgment will operate. *West Coast Exploration Co. v. McKay*, 213 F.(2d) 582 (1954). A necessary party is an entity that has an interest in the subject matter and should be made a party in order finally to determine the entire controversy but whose interest is separable. *Dunham v. Robertson*, 198 F.(2d) 316 (1952); *Kuhn v. Yellow Transit Freight Lines*, 12 F.R.D. 252 (1952); *Savoia Film v. Vanguard Films*, 10 F.R.D. 64 (1950). In *United States v. Hellard*, 322 U.S. 363, 88 L.Ed. 1326 (1944), partition proceedings were instituted in which the United States was not a party. The partition action was concluded in state court and following the partition action, a quiet title action was likewise commenced in state court against the Indian heirs. The United States removed the cause to the Federal District Court and alleged that the partition action was void for lack of the United States as a party. The court contrasted heirship

and partition proceedings pointing out that in proceedings to determine heirship, no governmental interest is directly involved since there is no alienation from Indian ownership. The court reiterated the rule that where an Indian's interest is alienated by judicial decree, the United States may cancel the judgment and set the conveyance aside where it is not a party to the action. Mr. Justice Douglas speaking for the court, pointed out that where governmental interests are involved, the United States has long been considered a necessary party. In the instant case, the government would not be foreclosed by a judgment against the Indians. We also submit that in the instant case, the United States in its capacity as guardian, must be interested in enforcing the rights of its Indian wards granted to them under the Treaty of 1855, when so large a part of the ability of the Skokomish Tribe to sustain itself on fish and shellfish is involved and it appears that a state has usurped Indian lands in direct derogation of its pledge not to do so. Thus when a conflict between Indian claims and the claims of white citizens are involved, the United States is a necessary party. It will be deemed not a necessary party only when no preservation of lands restricted for Indians is involved. This quiet title action brought by the Skokomish Tribe will include or exclude from tax-exempt Reservation land the real property in question. With its guardianship interest thus involved, United States is a necessary party. *Shade v. Downing*, 333 U.S. 586, 92 L.Ed. 894 (1948); *Lewis v. Hansen*, 227 P.(2d) 70 [Mont.] (1951). However, for the reasons already stated, it cannot be deemed an indispensable party.

II.

**The State of Washington Consented to This Action
Against It by Virtue of Its General Appearance and by
Virtue of Its Consent Given in Article XXVI of the
Washington State Constitution, Said Consent
Being a Prerequisite to Statehood**

A. We recognize that a state, as a sovereign, can not be sued without its consent. *Cherokee Nation v. Georgia*, 5 Pet. 1, 8 L.Ed. 25 (1831). Consent may arise, however, through legislative pronouncement or by an authorized waiver of such immunity from suit, through appearance and participation in the action. We believe that the State of Washington has consented to this action against it in the manner of its appearance and handling of this lawsuit. Article II, Section 26, of the Washington State Constitution provides that the legislature shall direct by law, in what manner, and in what courts, suits may be brought against the state. RCW 4.92.010 (Chap. 216, Sec. 1, Laws of 1927, amending Chap. 95, Sec. 1, Laws of 1895), provides, in part, that actions to quiet title to real property in which the state is a necessary or proper party defendant *may* be commenced and prosecuted to judgment against the state in the Superior Court of the county in which such real property is situated. It will be noted that the state courts are not the exclusive forum in which such a suit may be brought. Chap. 255, Sec. 194, Laws of 1927 (RCW 79.08.020) provides as follows:

“Duty of attorney general. It shall be the duty of the attorney general, to institute or defend, any action or proceeding to which the state, or the commissioner, or the board, is or may be a party, or in which the interests of the state are involved, in any court of this state, or any other state, or of the

United States, or in any department of the United States, or before any board of tribunal, when requested so to do by the commissioner, or the board, or upon his own initiative.

“The commissioner [of Public Lands] is authorized to represent the state in any such action or proceeding relating to any public lands of the state, except capitol building lands. [1927 c. 255 §194; RRS §7797-1947].”

This statute not only gives the attorney general the authority to defend an action against the state in a court of the United States but makes such his express and unqualified duty. It would appear that this statute is a legislative expression of its consent to be sued in the Federal Court as well as in the state court, especially with reference to the public lands of the state. The statute directs the attorney general to defend actions against the state either when requested to do so by the Commissioner of Public Lands or the Board of State Land Commissioners or upon the attorney general's own initiative.

In response to the summons and complaint filed herein, the attorney general filed a general notice of appearance [Transcript of Record, Page 38]. In *People el rel. Bird v. Detroit etc. Ry. Co.*, 121 N.W. 814, at page 819, the court considered a statute which provided as follows:

“It shall be the duty of the attorney general, at the request of the governor, the secretary of state, the treasurer, or the auditor general, to prosecute and defend all suits relating to matters connected with their departments.”

In considering that statute, the court stated:

“The state by these enactments, not only authorized these officers to appear and defend, but made

it their duty to do so. No discretion was lodged in them. If either refused, mandamus would lie to compel him to act in behalf of the state. It seems to be a rule of common sense and sound reasoning that the principle is responsible for the acts of his agent whom he has not only expressly authorized, but has commanded to act for him.”

RCW 79.08.020 is not in any way contradictory to the terms of RCW 4.92.010. The latter statute simply gives a citizen a right to maintain an action in state courts. It does not prohibit such a suit in the Federal court. While the state is ordinarily immune from suit, RCW 79.08.020 has, in effect, authorized actions of this nature in the Federal court and has absolutely commanded the attorney general to defend such actions. This argument has special force in the instant case where the state is involved in its proprietary rather than its governmental interest. See *Pape v. Armstrong*, 47 Wn.(2d) 480, 287 P.(2d) 1018 (1955); *Columbia Steel Co. v. State*, 34 Wn.(2d) 700, 209 P.(2d) 482 (1949). In 49 Am. Jur., States, Territories and Dependencies, Sec. 96, we find:

“Consent on the part of the state to be sued may be evidenced in a number of ways, including the enactment of a statute especially for that purpose. Such consent may be given or expressly authorized by the state Constitution. Certain limited consent of the state to be sued, namely, to be sued by another state or by a foreign state or country, is deemed to be given in view of Art. 3 of the Federal Constitution as limited by the Eleventh Amendment of the Constitution conferring original jurisdiction on the Supreme Court of a suit in which the state shall be a party. By their adoption of the

Federal Constitution the several states have consented to be made a party in the Supreme Court of the United States, by virtue of the original jurisdiction conferred on that court.

“A state may waive its immunity from suit, or consent to be sued, in other ways than by a formal declaration of consent in its Constitution or by statute. When it has sufficient interest to entitle it to become a party defendant, its appearance in court is a voluntary submission to its jurisdiction.”

See also 42 A.L.R. 1464, 1472; 50 A.L.R. 1408.

When the state made a general appearance in this matter in which it has a proprietary interest and made that appearance also in the light of RCW 79.08.020, it waived its immunity from suit and consented to be a party defendant to the action. Having waived its immunity and consented to the action, it must abide a judgment of the court whether from its viewpoint it be satisfactory or adverse. *Clark v. Barnard*, 108 U.S. 436, 2 S.Ct. 878, 27 L.Ed. 780 (1882); *Great Northern Life Ins. Co. v. Read*, 322 U.S. 47, 88 L.Ed. 1121, 1136 (1944).

B. The State of Washington has also consented to this action against it in view of the impact of the Treaty of 1855 (12 U.S. Statutes at Large 933), the Enabling Act, and the section of the Washington State Constitution (Article XXVI, Sec. Second) which adopts the compact required by the Enabling Act. In the case of *State v. Satiacum*, 50 Wn.(2d) 513, 314 P.(2d) 400 (1957), the Washington Supreme Court was concerned in construing a treaty with the Yakimas, likewise entered into in 1855. We quote at length from that decision:

“Article III of the treaty provides as follows:

“ ‘The right of taking fish, *at all usual and accustomed grounds and stations*, is further secured to said Indians, *in common with all citizens of the Territory*, and of erecting temporary houses for the purpose of curing, together with the privilege of hunting, gathering roots and berries, and pasturing their horses on open and unclaimed lands: . . . ’ (Italics ours.) 10 Stat. 1132.

“Since our decision in this case turns upon the proper construction of this article of the treaty, and since the supreme court of the United States is the only tribunal having the power to interpret authoritatively the United States constitution and treaties made thereunder, we find it necessary to review its decisions relating to the construction of Indian treaties.

“All Indian treaties entered into prior to 1871 were consummated pursuant to Art. II, §2 of the United States constitution. Article VI, commonly referred to as the ‘supremacy clause,’ provides:

“ ‘This Constitution, and the laws of the United States which shall be made in pursuance thereof; and *all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any state to the contrary notwithstanding.*’ (Italics ours.)

“The Supreme Court has consistently held that Indian treaties have the same force and effect as treaties with foreign nations, and consequently are the supreme law of the land and are binding upon state courts and state legislatures notwithstanding state laws to the contrary.” (Citing cases)

Thus, the treaty is controlling over the State Constitution and the State Constitution controlling over any claim of state immunity. Again we submit that the treaty must be interpreted in the sense in which it might have been understood by the Indians. See the landmark case of *United States v. Brookfield Fisheries*, 24 F. Supp. 712 (1938). We believe that the Indian would have looked to the federal courts for the protection of his rights and that so technical a concept as a state's immunity from suit would have been lost upon him. See also *Lone Wolf v. Hitchcock*, 187 U.S. 565, 23 S.Ct. 221, 47 L.Ed. 306 (1903).

There can be no question but what the State of Washington submitted itself to the jurisdiction of the federal courts when the people stated, in Article XXVI, § Second of the Washington State Constitution, that until the title to Indian land shall have been extinguished by the United States the same shall be and remain subject to the *disposition* of the United States and said Indian lands shall remain under the absolute jurisdiction and control of the Congress. It should not be forgotten that this section of the Washington Constitution must be considered with the oft-repeated rules that (1) what a state acquires by its Enabling Act is subordinate to the Indians' prior right of occupancy and (2) treaties between the Federal Government and Indian Nations have force and effect superior to that of the acts of state legislatures. *U. S. v. O'Brien*, 170 Fed. 508 (1904); *State ex rel. Irvine v. District Court*, 239 P.(2d) 272 [Mont.] (1951); *Anthony v. Veatch*, 220 P.(2d) 493 [Ore.] (1950). We also believe that had the United States properly assumed its duty by becoming a party to

this action, the reasoning of the *United States v. State of Washington*, 233 F.(2d) 811 (1956), would have applied with full force, insofar as the assumption of jurisdiction over the person of the State of Washington is concerned, even though trust lands are there involved.

It may be argued that the state has consented to suit but only in the state courts and pursuant to the Washington statute, but this matter deals with Indian *lands* which presents a special situation, and the United States has reserved jurisdiction over all Indian reserve lands under the Enabling Act, to which the people of the State of Washington have consented in the Washington State Constitution. *Vermillion v. Spotted Elk*, 85 N.W.(2d) 432 [N.D.] (1957). The *Vermillion* case involved the Enabling Act we have been discussing, which allowed North Dakota, South Dakota, Montana and Washington to become states. The same provision is to be found in the North Dakota Constitution as is contained in ours. Though the point is not directly involved, that opinion indicates that the Enabling Act and the disclaimer in the comparable section of the North Dakota State Constitution can be held to have reserved to the United States jurisdiction involving Indian lands. The jurisdiction in such matters being reserved to the Federal courts, it would be illogical to say that the Indian's remedy to enforce their rights in their lands is non-existent. Therefore, by virtue of the general appearance of the State in this action to protect a proprietary claim; by virtue of the submission to the jurisdiction of the United States and the waiver of immunity from suit by Indians endeavoring to protect their Reservation lands, both of which were required by

the Enabling Act as a condition of statehood; and by virtue of reason and common sense we feel that the State of Washington has submitted itself to the jurisdiction of the Federal courts and should not be dismissed as a party defendant. It would be a travesty of justice if the State, having entered a solemn compact to respect the rights of Indians to their lands, were to be permitted to nullify this guaranty by asserting a claim of immunity from suit. It must be held to have consented to suit to enforce the rights it vowed to observe—or its covenant is meaningless. Article I, Section 10, United States Constitution.

III.

Appellants Are Not Foreclosed by a Prior Acting Pending in the Superior Court of the State of Washington for Mason County Since the Issues There Presented Are Not Identical to the Issues Here Presented and the Proper Forum for the Cause Is the Federal Court

When action was commenced in the Superior Court of the State of Washington for Mason County, the main prayer of the plaintiff therein was for a determination of boundaries by a commission appointed by that court. Here the main prayer of the complaint is to quiet title in the Skokomish Indian tribe of all tidelands pertinent to the reservation uplands and which were granted to it by the treaty. A number of parties not involved in the present action are named before the Superior Court of the State of Washington.

As stated, the present action is premised upon the rights of the Skokomish Indian tribe founded on a claim in writing under a treaty of the United States. In this connection, the Act of June 25, 1948, 52 Stats. at Large 937, 248 U.S.C.A. 1441, provides in part as follows:

“(b) A civil action of which the District Courts have original jurisdiction founded on a claim or right arising under the constitution, treaties or laws of the United States, shall be removable without regard to the citizenship or residence of the plaintiffs. Any other such action shall be removable only if none of the parties in interest properly joined and served as defendants is a citizen of the state in which such action is brought.”

It is thus seen that this action even if commenced in the Superior Court would be removable to the Federal District Court. Therefore, the District Court properly has jurisdiction over the subject matter since neither the parties or the issues are identical.

IV.

The District Court Had Jurisdiction to Hear and Try the Issues and in Fact Is the Sole Forum Before Whom the Issues Could Be Presented

This action is one arising under a treaty and at least \$3,000 is involved. It arises under the treaty of 1855 [12 U.S. Stats. at Large 933] and all the tidelands involved exceed in value \$3,000 (Tr. of Record p. 49).

The problem of jurisdiction is set forth in 12 A.L.R. (2d) 29, as follows:

“In order to vest * * * jurisdiction on the ground that the case is one arising under the constitution, laws or treaties of the United States, the authorities unanimously agree that the asserted or alleged Federal question must be real and substantial.”

There can be no question but what the interpretation of this treaty is involved, dealing as it does with whether or not certain lands are included within the reservation

set aside for the Skokomish Indian tribe. Many cases have concerned themselves with the same question and Federal jurisdiction has never been doubted. See *Alaska Pacific Fisheries v. United States*, 228 U.S. 78; *Moore v. United States*, 157 F.(2d) 760 (1946).

We have set forth in the Appendix that section of Article VI of the Constitution of the United States which makes treaties of the United States secondary only to the Constitution of the United States. In *Seufert Bros. Co. v. United States*, 249 U.S. 194, 39 S.Ct. 203 (1919) the ownership of fishing rights located perhaps twenty-five miles from the Yakima Reservation was confirmed in the Indians, the court stating as follows:

“As stated by counsel for the appellant, the most important question in the case is this: ‘Did the treaty with the Yakima tribes of Indians ceding to the United States lands occupied by them, on the north side of the Columbia River in the territory of Washington, and reserving to the Indians “the right of taking fish at all usual and accustomed places in common with citizens of the territory,” give them the right to fish in the country of another tribe on the south, or Oregon, side of the river?’ ”

We urge that since the United States Supreme Court could confirm the right of a tribe to fish twenty-five miles from the boundary of the Yakima Reservation, which Reservation was created by a similar treaty [12 U.S. Statutes at Large 951 (1855)], that a substantial question was there involved and is likewise involved here. A substantial Federal question being involved, jurisdiction of the Federal courts to construe the Treaty of 1855 with the Skokomish to include the tidelands adjacent to their reservation is established. We note

that similar inclusions of area were accorded in *Moore v. U. S.*, 157 F.(2d) 760 (1946); *State v. Edwards*, 188 Wash. 467, 62 P.(2d) 1094 (1936) and many other cases.

As we have pointed out and as can be seen from the constitutions and treaties set forth herein, the exclusive right of fishing of the Skokomish Indian tribe was to be free from interference from the State of Washington or any person or persons claiming under or by virtue of any title granted them by the States of Washington, the lands in the reservation of the Indians were to be free from such interference and the protection of these rights was to be found in the exclusive jurisdiction of the United States.

In 28 U.S.C.A. §1360 we find:

“(a) Each of the States listed in the following table shall have jurisdiction over civil causes of action between Indians or to which Indians are parties which arise in the areas of Indian country listed opposite the name of the State to the same extent that such State has jurisdiction over other civil causes of action, and those civil laws of such State that are of general application to private persons or private property shall have the same force and effect within such Indian country as they have elsewhere within the State:

State of	Indian country affected
California.....	All Indian country within the State
Minnesota.....	All Indian country within the State, except the Red Lake Reservation
Nebraska.....	All Indian country within the State
Oregon.....	All Indian country within the state, except the Warm Springs Reservation.

Wisconsin.....All Indian country within the State.

“(b) Nothing in this section shall authorize the alienation, encumbrance, or taxation of any real or personal property, including water rights, belonging to any Indian or any Indian tribe, band, or community that is held in trust by the United States or is subject to a restriction against alienation imposed by the United States; or shall authorize regulation of the use of such property in a manner inconsistent with any Federal treaty, agreement, or statute or with any regulation made pursuant thereto; or shall confer jurisdiction upon the State to adjudicate, in probate proceedings or otherwise, the ownership or right to possession of such property or any interest therein.

“ * * * ”

The legislative history of this Act adopted in 1953 is enlightening on our problem of the jurisdiction of the Federal court, indeed the exclusive Federal jurisdiction, of this cause. The legislative history reads in part as follows:

“Your committee has amended the printed bill by adopting substitute language which operates to
* * *

“(2) Give consent of the United States to those states presently having organic laws expressly disclaiming jurisdiction to acquire jurisdiction subsequent to enactment by amending or repealing such disclaimer laws.

“Examination of the Federal statutes and State constitutions has revealed that enabling acts for eight States, and in consequence the constitutions of those States, contain express disclaimers of jurisdiction. Included are Arizona, Montana, New Mexico, North Dakota, Oklahoma, South Dakota,

Utah and Washington. Effect of the disclaimer of jurisdiction over Indian land within the borders of these States in the absence of consent being given for future action to assume jurisdiction — is to retain exclusive Federal jurisdiction until Indian title in such lands is extinguished; such States could, under the bill as reported, proceed to amendment of their respective organic laws by proper amending procedure.” 1953 U.S.C.C. & A.N., Vol. 2, p. 2412.

In a letter from the Assistant Secretary of the Interior written on July 7, 1953, which likewise appears in legislative history, we find the following statement:

“It appears that there are legal impediments to the transfer of jurisdiction over Indians on their reservations in the case of a number of States. An examination of the Federal statutes and State constitutions indicates that enabling acts for the following States, and in consequence the constitutions of these States, contain express disclaimers of jurisdiction. These States are Arizona, Montana, New Mexico, North Dakota, Oklahoma, South Dakota, Utah and Washington. In these cases the enabling acts required the people of the proposed States expressly to disclaim jurisdiction over Indian land and that, until the Indian title was extinguished, the lands were to remain under the absolute jurisdiction and control of the Congress of the United States. In each instance the State constitution contains an appropriate disclaimer. It would appear in each case, therefore, that the Congress would be required to give its consent and the people of each State would be required to amend the State constitution before the State legally could assume jurisdiction.” 1953 U.S.C.C. & A.N., Vol. 2, p. 2414.

The lands here in question are subject to a restriction against alienation, which has been imposed by the United States. We submit that the Superior Court of the State of Washington has no jurisdiction to adjudicate the ownership or right to possession of this property of the Skokomish Indian Reservation or any interest therein. We further submit that the jurisdiction of the Federal Court is clear and that the District Court should be directed to hear and try the issue on the merits.

* * *

SUMMARY OF ARGUMENT and CONCLUSION

We submit that the District Court erred in failing to rule that the United States was a necessary party to the action though not an indispensable one. The United States is not indispensable since the Skokomish Tribe has the capacity to sue in its own behalf. The United States is necessary as a party because it will not be foreclosed by any judgment in this action unless it is a party, because it is its sacred duty to uphold its Treaty obligations to the Skokomish Tribe, and because it is its duty to protect the reserved lands of its dependent Indian wards.

We submit the District Court erred in dismissing the State of Washington as a defendant in view of its general appearance and the consent to suit which was required of the State in consideration for its admission into the Union.

It is also our conclusion that the District Court erred in considering that any action pending in a Washing-

ton State Court would bar the present action. We do not believe this is part of the basis upon which the District Court dismissed the action, but it may have been a consideration and we believe that such a consideration is refuted by our argument herein.

We are at a loss to understand upon what grounds the District Court dismissed the balance of the litigation since the exclusion of the United States and the State of Washington does not preclude the appellant from its remedy against the encroachment of the remaining parties.

We ask that the Order of Dismissal of the District Court be reversed, that the United States be held to be a necessary party to the action and required to join as a party plaintiff, that the State of Washington be restored as a party defendant, and that the District Court be instructed to try the cause on its merits.

Respectfully submitted,

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APPENDIX

Constitution of the United States, Article VI

“DEBTS, SUPREMACY, OATH. * * *

“This Constitution, and the laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the supreme law of the land; and the judges in every state shall be bound thereby, any thing in the Constitution or laws of any state to the contrary notwithstanding.

“ * * * . ”

* * *

12 United States Statutes at Large 933

Treaty between the United States of America and the S'Klallams Indians. Concluded at Point no Point, Washington Territory, January 26, 1855; Ratified by the Senate, March 8, 1859; Proclaimed by the President of the United States, April 29, 1859.

JAMES BUCHANAN,

PRESIDENT OF THE UNITED STATES OF AMERICA:

To all and singular to whom these presents shall come,
Greeting:

WHEREAS a Treaty was made and concluded at Hahd Skus, or Point no Point, in Washington Territory, on the twenty-sixth day of January, eighteen hundred and fifty-five, between Isaac I. Stevens, Governor and Superintendent of Indian Affairs for the said Territory, on the part of the United States, and the hereinafter named Chiefs, Headmen, and Delegates of the different villages of the S'Klallams Indians, viz.: the Kah-tai, Squah-quaintl, Tch-queen, Ste-techtlum, Tsohkw, Yennis, El-hwa, Pishtst, Hunnint, Klat-la-wash, and Okeno, and also of the Sko-ko-mish, Too-an-hooch, and Chema-kum tribes occupying certain lands on the straits

of Fuca and Hood's Canal, in the Territory of Washington, on behalf of said tribes, and duly authorized by them; which treaty is in the words and figures following, to-wit:

Articles of agreement and convention, made and concluded at Hahdskus, or Point no Point, Suquamish Head, in the Territory of Washington, this twenty-sixth day of January, eighteen hundred and fifty-five, by Isaac I. Stevens, governor and superintendent of Indian affairs for the said Territory, on the part of the United States, and the undersigned chiefs, headmen, and delegates of the different villages of the S'Klallams, viz.: Kah-tai, Squah-quaihtl, Tch-queen, Ste-tehtlum, Tsohkw, Yennis, Elhwa, Pishtst, Hun-nint, Klat-lawash, and Oke-ho, and also of the Sko-ko-mish, To-an-hooch and Chem-a-kum tribes, occupying certain lands on the straits of Fuca and Hood's Canal in the Territory of Washington, on behalf of said tribes, and duly authorized by them.

ARTICLE I. The said tribes and bands of Indians hereby cede, relinquish, and convey to the United States all their rights, title, and interest in and to the lands and country occupied by them, bounded and described as follows, viz.: commencing at the mouth of the Okeho River, on the Straits of Fuca, thence southeastwardly along the westerly line of Territory claimed by the Makah tribe of Indians to the summit of the Cascade Range; thence still southeastwardly and southerly along said summit to the head of the west branch of the Satsop River, down that branch to the main fork; thence eastwardly and following the line of lands heretofore ceded to the United States by the Nisqually and other tribes and bands of Indians, to the summit of the Black Hills, and northeastwardly to the portage known as Wilkes' portage; thence northeastwardly, and following the line of lands heretofore ceded to the

United States by the Dwamish, Suquamish, and other tribes and bands of Indians to Suquamish Head; thence northerly through Admiralty Inlet to the Straits of Fuca; thence westwardly through said straits to the place of beginning; including all the right, title, and interest of the said tribes and bands to any land in the Territory of Washington.

ARTICLE II. There is, however, reserved for the present use and occupation of the said tribes and bands the following tract of land, *viz.*: the amount of six sections, or three thousand eight hundred and forty acres, situated at the head of Hood's Canal, to be hereafter set apart, and so far as necessary surveyed and marked out for their exclusive use; nor shall any white man be permitted to reside upon the same without permission of the said tribes and bands, and of the superintendent or agent; but, if necessary for the public convenience, roads may be run through the said reservation, the Indians being compensated for any damage thereby done them. It is, however, understood that should the President of the United States hereafter see fit to place upon the said reservation any other friendly tribe or band, to occupy the same in common with those above mentioned, he shall be at liberty to do so.

ARTICLE III. The said tribes and bands agree to remove to and settle upon the said reservation within one year after the ratification of this treaty, or sooner if the means are furnished them. In the meantime, it shall be lawful for them to reside upon any lands not in the actual claim or occupation of citizens of the United States, and upon any land claimed or occupied, if with the permission of the owner.

ARTICLE IV. The right of taking fish at usual and accustomed grounds and stations is further secured to said Indians, in common with all citizens of the United States; and of erecting temporary houses for the pur-

pose of curing; together with the privilege of hunting and gathering roots and berries on open and unclaimed lands. *Provided, however,* That they shall not take shellfish from any beds staked or cultivated by citizens.

ARTICLE V. In consideration of the above cession, the United States agree to pay to the said tribes and bands the sum of sixty thousand dollars, in the following manner, that is to say: during the first year after the ratification hereof, six thousand dollars; for the next two years, five thousand dollars each year; for the next three years, four thousand dollars each year; for the next four years, three thousand dollars each year; for the next five years, two thousand four hundred dollars each year; and for the next five years, one thousand six hundred dollars each year. All which said sums of money shall be applied to the use and benefit of the said Indians under the direction of the President of the United States, who may from time to time determine at his discretion upon what beneficial objects to expend the same. And the superintendent of Indian Affairs, or other proper officer, shall each year inform the President of the wishes of said Indians in respect thereto.

* * *

ARTICLE IX. The said tribes and bands acknowledge their dependence on the government of the United States, and promise to be friendly with all citizens thereof; and they pledge themselves to commit no depredations on the property of such citizens. And should any one or more of them violate this pledge, and the fact be satisfactorily proven before the agent, the property taken shall be returned, or in default thereof, or if injured or destroyed, compensation may be made by the government out of their annuities. Nor will they make war on any other tribe, except in self defense, but will submit all matters of difference between them and other Indians to the government of the United States, or its

agent, for decision, and abide thereby. And if any of the said Indians commit any depredations on any other Indians within the Territory, the same rule shall prevail as that prescribed in this article in cases of depredations against citizens. And the said tribes agree not to shelter or conceal offenders against the United States, but to deliver them up for trial by the authorities.

48 United States Statutes at Page 984

73d Congress Sess. II Ch. 576

AN ACT

To conserve and develop Indian lands and resources; to extend to Indians the right to form business and other organizations; to establish a credit system for Indians; to grant certain rights of home rule to Indians; to provide for vocational education for Indians; and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That hereafter no land of any Indian reservation, created or set apart by treaty or agreement with the Indians, Act of Congress, Executive order, purchase, or otherwise, shall be allotted in severalty to any Indian.

Sec. 2. The existing periods of trust placed upon any Indian lands and any restriction on alienation thereof are hereby extended and continued until otherwise directed by Congress.

* * *

Sec. 4. Except as herein provided, no sale, devise, gift, exchange or other transfer of restricted Indian lands or of shares in the assets of any Indian tribe or corporation organized hereunder, shall be made or approved: *Provided, however,* That such lands or interests may, with the approval of the Secretary of the Interior, be sold, devised, or otherwise transferred to the Indian

tribe in which the lands or shares are located or from which the shares were derived or to a successor corporation; and in all instances such lands or interests shall descend or be devised, in accordance with the then existing laws of the State, or Federal laws where applicable, in which said lands are located or in which the subject matter of the corporation is located, to any member of such tribe or of such corporation or any heirs of such member:

* * *

Title to any lands or rights acquired pursuant to this Act shall be taken in the name of the United States in trust for the Indian tribe or individual Indian for which the land is acquired, and such lands or rights shall be exempt from State and local taxation.

* * *

Sec. 16. Any Indian tribe, or tribes, residing on the same reservation, shall have the right to organize for its common welfare, and may adopt an appropriate constitution and bylaws, which shall become effective when ratified by a majority vote of the adult members of the tribe, or of the adult Indians residing on such reservation, as the case may be, at a special election authorized and called by the Secretary of the Interior under such rules and regulations as he may prescribe. Such constitution and bylaws when ratified as aforesaid and approved by the Secretary of the Interior shall be revocable by an election open to the same voters and conducted in the same manner as hereinabove provided. Amendments to the constitution and bylaws may be ratified and approved by the Secretary in the same manner as the original constitution and bylaws.

In addition to all powers vested in any Indian tribe or tribal council by existing law, the constitution adopted by said tribe shall also vest in such tribe or its tribal council the following rights and powers: To employ

legal counsel, the choice of counsel and fixing of fees to be subject to the approval of the Secretary of the Interior; to prevent the sale, disposition, lease, or encumbrance of tribal lands, interests in lands, or other tribal assets without the consent of the tribe; and to negotiate with the Federal, State, and local Governments. The Secretary of the Interior shall advise such tribe or its tribal council of all appropriation estimates or Federal projects for the benefit of the tribe prior to the submission of such estimates to the Bureau of the Budget and the Congress.

Sec. 17. The Secretary of the Interior may, upon petition by at least one-third of the adult Indians, issue a charter of incorporation to such tribe: *Provided*, That such charter shall not become operative until ratified at a special election by a majority vote of the adult Indians living on the reservation. Such charter may convey to the incorporated tribe the power to purchase, take by gift, or bequest, or otherwise, own, hold, manage, operate, and dispose of property of every description, real and personal, including the power to purchase restricted Indian lands and to issue in exchange therefor interests in corporate property, and such further powers as may be incidental to the conduct of corporate business, not inconsistent with law, but no authority shall be granted to sell, mortgage, or lease for a period exceeding ten years any of the land included in the limits of the reservation. Any charter so issued shall not be revoked or surrendered except by Act of Congress.

* * *

Indians of the Pacific Northwest

The following is from *Indians of the Pacific Northwest*, 1945, Bureau of Indian Affairs, Dr. Ruth Underhill:

Indians of the Pacific Northwest is primarily devoted

to the coastal strip from the Cascades to the Pacific Ocean and from the Canadian boundary to the northern California boundary, pp. 9-10.

“In all this country, the way of life was much the same, though many different tribes lived there.”

p. 9.

The Skokomish or Twanoh are identified as one of the coast tribes and belonging to the Salish language group, p. 13.

The extensive use of the shellfish is described at pages 28-30 and includes:

“SHELLFISH.

“The big fish were caught by men but there were some kinds of sea food usually gathered by women. Among these were shellfish: clams, rock oysters, mussels and barnacles found on the rocks revealed at low tide. Groups of women went out after these with their baskets, just as they went for berries, and dried them by the bushel for winter use. There are stories of lost girls with no man to fish for them, who live very well on the seafood they got for themselves.

“Chief of these was the clam, in at least six varieties, listed at the end of this chapter. It was the Indians who taught Northwest pioneers where to find these clams and how to appreciate them. They must have been a food of coast peoples for thousands of years for Copalis, a favorite Indian beach of the Washington coast, has heaps of clam shells many miles long and many feet deep.

“Groups of families used to journey to such a beach in June and July, when the clams are at their best and milkiest. If they had a beach near home the women and children would walk to it every

day or else paddle there in canoes. Sometimes they had slaves to help them. The tale is that Raven, when he was a slave, stole the South Wind's daughter and thus made him stop sending storms, for these drove the tide too far up the beach and the clams were never uncovered.

“Women had special baskets for clam gathering (E, p. 63). These were cleverly made of openwork, which allowed the water to drip out, making the worker's load lighter with every step she plodded toward home.

* * *

“At low tide women might find crabs in the pools, particularly those called soft shelled because in summer, when the shell is changing, it is so soft that it can be boiled and eaten with the crab. The larger ones lived in deep water where the men went out in canoes to dip them up by the netful. Such crabs are a feature of coast restaurants today.

“Up the streams, the women could get herring eggs. They might scrape these off the sticks and stones at the bottom of a stream, where the fish liked to lay them, but a better way was to prepare the ground by laying cedar branches under the water. After the spawning season, the branch would be found full of eggs and each woman could pull out her own and take it home.”

The following is a list of the names of the persons who have been
admitted to the office of the Secretary of the Board of Education
since the last meeting of the Board, and the date of their admission.
The names are arranged in alphabetical order, and the date of admission
is given in parentheses. The names of the persons who have been
admitted to the office of the Secretary of the Board of Education
since the last meeting of the Board, and the date of their admission,
are as follows:

Name	Date of Admission
Mr. J. H. Smith	(1885)
Mr. W. H. Jones	(1886)
Mr. T. H. Brown	(1887)
Mr. R. H. White	(1888)
Mr. S. H. Black	(1889)
Mr. L. H. Green	(1890)
Mr. M. H. Gray	(1891)
Mr. N. H. Hall	(1892)
Mr. O. H. King	(1893)
Mr. P. H. Lee	(1894)
Mr. Q. H. Clark	(1895)
Mr. R. H. Adams	(1896)
Mr. S. H. Baker	(1897)
Mr. T. H. Carter	(1898)
Mr. U. H. Evans	(1899)
Mr. V. H. Foster	(1900)
Mr. W. H. Gibson	(1901)
Mr. X. H. Harris	(1902)
Mr. Y. H. Hill	(1903)
Mr. Z. H. Hunt	(1904)
Mr. A. H. Ingram	(1905)
Mr. B. H. Jackson	(1906)
Mr. C. H. Johnson	(1907)
Mr. D. H. Jones	(1908)
Mr. E. H. Keith	(1909)
Mr. F. H. Lester	(1910)
Mr. G. H. Little	(1911)
Mr. H. H. Long	(1912)
Mr. I. H. Martin	(1913)
Mr. J. H. Miller	(1914)
Mr. K. H. Moore	(1915)
Mr. L. H. Myers	(1916)
Mr. M. H. Nichols	(1917)
Mr. N. H. Oliver	(1918)
Mr. O. H. Parker	(1919)
Mr. P. H. Quinn	(1920)
Mr. R. H. Reed	(1921)
Mr. S. H. Richmond	(1922)
Mr. T. H. Roberts	(1923)
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Mr. L. H. Thomas	(2097)
Mr. M. H. Thomas	(2098)
Mr. N. H. Thomas	(2099)
Mr. O. H. Thomas	(2100)

**In the United States Court of Appeals
for the Ninth Circuit**

SKOKOMISH INDIAN TRIBE, APPELLANT

v.

E. L. FRANCE, TRUSTEE, ET AL., APPELLEES

**Upon Appeal from the United States District Court
for the Western District of Washington,
Southern Division**

BRIEF FOR THE UNITED STATES, APPELLEE

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FILE

INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	2
Statement	2
Argument	3
I. The United States cannot be joined as a party to this case without its consent.....	3
II. The case may proceed in the absence of the United States.....	6
Conclusion	7

CITATIONS

Cases:

<i>Booth v. Fletcher</i> , 101 F.2d 676, cert. den. 307 U.S. 628	5
<i>Castell v. United States</i> , 98 F.2d 88, cert. den. 307 U.S. 628	5
<i>Choctaw and Chickasaw Nations v. Seitz</i> , 193 F.2d 456, cert. den. 343 U.S. 919.....	4, 6
<i>Daggs v. Klein</i> , 169 F.2d 174.....	6
<i>Ill. Cent. R.R. Co. v. Public Utilities Comm.</i> , 245 U.S. 493	5
<i>McGugin v. United States</i> , 109 F.2d 694.....	4
<i>New York v. New Jersey</i> , 256 U.S. 296.....	5
<i>Sioux Tribe of Indians v. United States</i> , 146 F.Supp. 229 (C.Cls. 1956).....	4
<i>Truman Fertilizer Co. v. Larson</i> , 196 F.2d 910....	6
<i>United States v. California</i> , 332 U.S. 19.....	5
<i>United States v. Hall</i> , 145 F.2d 781, cert. den. 324 U.S. 871.....	5
<i>United States v. Shaw</i> , 309 U.S. 495.....	4
<i>United States v. Sherwood</i> , 312 U.S. 584.....	4, 6
<i>United States v. U. S. Fidelity Co.</i> , 309 U.S. 506..	4

Miscellaneous:

Rule 19, F.R.Civ.P.....	6
Federal Indian Law, Dept. of the Interior, 1958....	4, 6, 7

Opinion

Justice

Chief Justice

Associate Justice

Associate Justice

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**In the United States Court of Appeals
for the Ninth Circuit**

No. 16008

SKOKOMISH INDIAN TRIBE, APPELLANT

v.

E. L. FRANCE, TRUSTEE, ET AL., APPELLEES

**Upon Appeal from the United States District Court
for the Western District of Washington,
Southern Division**

BRIEF FOR THE UNITED STATES, APPELLEE

OPINION BELOW

The court's oral decision (R. 129-131) is not reported. An earlier memorandum opinion of Judge Lindberg (R. 47-53) is not reported.

JURISDICTION

This is an appeal filed January 6, 1958 (R. 134) from an order dismissing, for lack of jurisdiction, a suit instituted by the Skokomish Indian Tribe (R. 132-134). The complaint asserted that jurisdiction existed because plaintiff was an Indian Tribe, the rights demanded arose out of a treaty with the

United States, and more than \$3,000 was involved (R. 4). The jurisdiction of this Court is invoked under 28 U.S.C., sec. 1291.

QUESTIONS PRESENTED

1. Whether the United States has consented to be joined as a party to this quiet title suit instituted by an Indian Tribe.

2. Whether the United States is so essential a party that such a suit may not proceed in its absence.

STATEMENT

The Skokomish Indian Tribe on December 3, 1948, filed a complaint to quiet title to lands alleged to constitute tidelands bordering the plaintiff's reservation (R. 4-33). Claimed fishing rights were also involved. The United States was named as a party defendant because of possible interest of the Bonneville Power Administration in one of the tracts (R. 31). However, by stipulation stating that that Administration had no interest (R. 33-35), the case was dismissed as to the United States (R. 36).

Motions to dismiss were made by the State of Washington and by many defendants who claimed under deeds and leases from the State (R. 35, 37-38, 39-46). These were denied by Judge Lindberg by a memorandum opinion dated July 16, 1952 (R. 47-53). A pre-trial order entered October 1, 1956, by Judge Boldt revealed several jurisdictional objections (R. 93, 96, 99, 100, 102). At a hearing on June 12, 1957, Judge Boldt expressed doubt about jurisdiction and suggested that perhaps the questions

might be resolved by joining the United States as a party (R. 117-124). Appellant thereupon moved to join the United States as a party plaintiff (R. 125-126). By memorandum filed August 1, 1957, the United States Attorney appeared specially and challenged the motion for lack of jurisdiction stating, however, that the United States was not a necessary party (R. 127-128). At a hearing on October 2, 1957, the court expressed the view that the United States could be made a party "by implication" but that it was an indispensable party (R. 130). Both of these questions, it said, should be resolved by a loftier tribunal and to permit review prior to lengthy trial, it denied the motion to join the United States, dismissed the case as to the State for lack of consent to suit and dismissed the rest of the case for lack of jurisdiction (R. 131-133).

ARGUMENT

I

The United States Cannot Be Joined As A Party To This Case Without Its Consent

Appellant's brief contains a lengthy discussion of the legal relationship between the United States and Indian Tribes (Br. 7-29). Constantly asserted is the idea that it is the guardian and trustee of the tribe, is under a duty to bring this suit and hence may compulsorily be joined as a party plaintiff (e.g., Br. 12-13, 15, 16, 19, 20, 21, 22, 24, 44). We disagree with many of these assertions and with appellant's interpretation of many of the cases cited. For example, while the Federal-Indian relationship

has been said many times to "resemble" that of guardian and ward (e.g., Br. 14), the legal obligations of a true guardianship do not prevail. See *Sioux Tribe of Indians v. United States*, 146 F.Supp. 229, 237-238 (C.Cls. 1956).¹ Cf. *McGugin v. United States*, 109 F.2d 694 (C.A. 10, 1940) holding that a suit by the United States to collect funds belonging to Jackson Barnett illegally transferred did not abate upon the death of Barnett. It is unnecessary and, we believe, inappropriate here to discuss at length what obligation the United States may owe to appellant tribe. In any event, compulsory joinder to this action would violate the sovereign immunity from suit.

A court has jurisdiction of the United States only so far as Congress may have consented. *United States v. Shaw*, 309 U.S. 495, 500 (1940); *United States v. Sherwood*, 312 U.S. 584, 586 (1941). In *United States v. U. S. Fidelity Co.*, 309 U.S. 506 (1940) the court said (p. 514): "Consent alone gives jurisdiction to adjudge against a sovereign. Absent that consent, the attempted exercise of judicial power is void". In *Choctaw and Chickasaw Nations v. Seitz*, 193 F.2d 456 (C.A. 10, 1951), cert. den. 343 U.S. 919, the precise problem of this case was presented when the tribes sought to quiet title to certain lands and the defendants objected that the United

¹ In *Federal Indian Law*, (Dept. of Int. 1958) after summarizing the elements of a common law guardianship it is said (p. 557): "It is clear that this relationship does not exist between the United States and the Indians, although there are important similarities and suggestive parallels between the two relationships".

States was a necessary party. The Tribe sought to join the United States as a "third party defendant". The court of appeals affirmed an order dismissing the action as to the Government on the ground that it had not consented to be sued. This and the other cases cited above make it clear that sovereign immunity is the same whether Indians or other parties are involved.

Nor can a distinction be made on the ground that here it is sought to join the United States as a party plaintiff. The immunity extends to any attempt to adjudicate the Government's rights whether it takes the form of a cross-claim (*United States v. U. S. Fidelity Co., supra*) *Ill. Cent. R.R. Co. v. Public Utilities Comm.*, 245 U.S. 493, 504-505 (1918), or otherwise. Moreover, except for some special cases, Congress has given the Attorney General exclusive authority to determine when and where suits may be instituted in the name of the United States. *United States v. California*, 332 U.S. 19, 26-29 (1947); *United States v. Hall*, 145 F.2d 781 (C.A. 9, 1944), cert. den. 324 U.S. 871; *Booth v. Fletcher*, 101 F.2d 676, 681-682, (C.A. D.C., 1938), cert. den. 307 U.S. 628; *New York v. New Jersey*, 256 U.S. 296, 307-308 (1921); *Castell v. United States*, 98 F.2d 88, 91 (C.A. 2, 1938), cert. den. 307 U.S. 628. The courts have not been vested with any power to review his decision in this regard. See *Booth v. Fletcher, supra*, pp. 681-682. In addition, even if it be assumed that there is some authority to review the Attorney General's decision, the case would have to be filed in the District of Columbia courts which

alone have jurisdiction over cabinet officers acting in their official capacities. *Daggs v. Klein*, 169 F.2d 174, 176 (C.A. 9, 1948); *Truman Fertilizer Co. v. Larson*, 196 F.2d 910, 911 (C.A. 5, 1952), and cases there cited.

Federal Rule of Civil Procedure 19 does not alter these principles. It is plainly limited to those persons over whom the court has jurisdiction "as to both service of process and venue" (Br. 27). The authority to make rules of civil procedure for exercise of the court's jurisdiction "is not an authority to enlarge that jurisdiction", hence a consent to sue the United States cannot be found in the Federal Rules. *United States v. Sherwood*, 312 U.S. 584, 590 (1941). The court's refusal to join the United States as a party was, we submit, plainly correct.

II

The Case May Proceed In The Absence Of The United States

In *Choctaw and Chickasaw Nations v. Seitz*, 193 F.2d 456 (C.A. 10, 1951), cert. den. 343 U.S. 919, the court held that the fact that the United States would not be bound by the judgment was not sufficient reason to deny the Indian Tribe the right to assert its claim to certain property. The court there said (p. 461): "We conclude that a final decree determining the title and right to possession as between the Nations and the defendants would not leave the controversy in a situation inconsistent with equity and good conscience". We submit that this decision should be followed by this Court. Cf. *Fed-*

eral Indian Law, Dept. of the Interior, 1958, pp. 336-337.

CONCLUSION

For the foregoing reasons, we submit that the order should be affirmed so far as it refuses to join the United States as a party but should be reversed so far it holds the United States to be an indispensable party. Comment by us on other jurisdictional questions that may be presented seems inappropriate.

Respectfully,

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DECEMBER 1958

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United States Court of Appeals for the Ninth Circuit

SKOKOMISH INDIAN TRIBE, *Appellant*

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INDEX

	<i>Page</i>
I. THE DISTRICT COURT HAS JURISDICTION OF THIS CASE.....	1
A. A Federal Question is Involved Because the Case Turns on the Interpretation of a Treaty of the United States.....	2
B. The Required Jurisdictional Amount is Involved in This Case.....	7
II. REPLY TO THE UNITED STATES: THE UNITED STATES IS A NECESSARY, BUT NOT AN INDISPENSABLE, PARTY TO THIS ACTION	9
III. REPLY TO APPELLEE STATE OF WASHINGTON: THE STATE HAS CONSENTED TO BE SUED.....	12
IV. CONCLUSION	15

TABLE OF CASES

<i>Amaya v. Stanolind Oil & Gas Co.</i> , 158 F.(2d) 554.....	14
<i>Bateman v. Southern Ore Company</i> , 217 Fed. 933	9
<i>Brown v. Stufflebean</i> , 187 F.(2d) 347 (1951).....	5
<i>Century Insurance Company v. Mooney</i> , 241 F.(2d) 910 (1957).....	9
<i>Choctaw and Chickasaw Nations v. Seitz</i> , 193 F.(2d) 456 (1951).....	9, 10, 11
<i>Cornell v. Mabe</i> , 206 F.(2d) 514 (1953).....	8
<i>Gully v. First National Bank</i> , 299 U.S. 109, 81 L.Ed. 70.....	2

	<i>Page</i>
<i>McCauley v. Makah Indian Tribe</i> , 128 F.(2d) 867 (1942)	7
<i>Martinez v. Southern Ute Tribe of Southern Ute Reservation</i> , 249 F.(2d) 915 (1957).....	3
<i>Mercer Island Beach Club v. Pugh</i> , 153 Wn. Dec. 421 (1959).....	14
<i>Montana Power Company v. Rochester</i> , 127 F.(2d) 189 (1942).....	7
<i>Moore v. United States</i> , 157 F.(2d) 760.....	3
<i>Narrows Realty Company, Inc. v. State</i> , 152 Wn. Dec. 788 (1958).....	14
<i>Norton v. Larney</i> , 266 U.S. 511, 69 L.Ed. 413 (1925)	4
<i>Osage Tribe of Indians v. United States</i> , 66 Ct. Cl. 64 (1928).....	3
<i>Peterson v. Sucro</i> , 93 F.(2d) 878 (1938).....	7
<i>Phelps v. Hanson</i> , 163 F.(2d) 973 (1947).....	2
<i>Shively v. Bowlby</i> , 152 U.S. 1, 38 L.Ed. 331, 14 Sup. Ct. 548.....	6
<i>Shoshone Tribe v. United States</i> , 299 U.S. 476, 81 L.Ed. 360, 57 Sup. Ct. 244.....	3
<i>Shulthis v. McDougall</i> , 225 U.S. 561, 56 L.Ed. 1205 (1912).....	3
<i>Sioux Tribe of Indians v. United States</i> , 316 U.S. 317, 86 L.Ed. 1501 (1942).....	3
<i>Teeters v. Henton</i> , 43 F.(2d) 175 (1930).....	2
<i>United States v. Ashton</i> , 170 Fed. 509 (1909).....	6
<i>United States v. Candelaria</i> , 271 U.S. 432, 70 L.Ed. 1023 (1926).....	11
<i>United States v. Taylor</i> , 33 F.(2d) 608 (1929).....	7
<i>United States v. Winans</i> , 198 U.S. 371, 25 Sup. Ct. 662 (1905).....	5

TEXTBOOKS

Blumenthal, American Indians Dispossessed, Page 167	15
Cohen, Federal Indian Law, Page 329.....	5

STATUTES

RCW 79.01.736, Laws of Washington 1927, Ch. 255, §194.....	12, 13
U.S.C. Title 25, §71.....	3
U.S.C. Title 28, §§1331 and 1345.....	1
12 U.S. Stat. at Large 933.....	10
10 U.S. Stat. at Large, c.90 p.172 (Organic Act)	13
25 U.S. Stat. at Large, c.180 p.676 (Enabling Act)	13

CONSTITUTION

Washington State Constitution: Art. XXVI, § Second.....	14, 18
--	--------

TREATIES

Treaty of 1855, United States-Skokomish Indians 12 Stat. at Large 933.....	10
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Volume

8

Page

Page

Page

Page

Page

Page

Page

Page

Page

Page

Page



United States Court of Appeals

for the Ninth Circuit

SKOKOMISH INDIAN TRIBE, *Appellant*

vs.

E. L. FRANCE, TRUSTEE, *et al.*, *Appellees*

Docket
No. 16008

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON
SOUTHERN DIVISION

REPLY BRIEF OF APPELLANT SKOKOMISH INDIAN TRIBE

In this reply brief we will restrict ourselves to a discussion of the question of federal jurisdiction and to a reply to such matters raised in the answering briefs of the United States, the State of Washington and the individual appellees as are not concerned with the jurisdictional question and are in issue on this appeal.

I. THE DISTRICT COURT HAS JURISDICTION OF THIS CASE

As stated in appellant's opening brief, jurisdiction is based on U.S.C. Title 28, §§1331 and 1345. We will confine ourselves at this time to a discussion of the impact of U.S.C. Title 28, §1331. We quote that brief section in full:

"Section 1331. *Federal question; amount in controversy.*

The district courts shall have original juris-

diction of all civil actions wherein the matter in controversy exceeds the sum or value of \$3,000, exclusive of interest and costs, and arises under the Constitution, laws or treaties of the United States. June 25, 1948, c.646, 62 Stat. 930.”

The statute was amended on July 25, 1958, to increase the jurisdictional amount to \$10,000. It is set out here as it existed at the time of the commencement of this action.

A. A FEDERAL QUESTION IS INVOLVED BECAUSE THE CASE TURNS ON THE INTERPRETATION OF A TREATY OF THE UNITED STATES.

We believe that the central question involved in this action is whether the treaty with the S'klallam Indians and with the Skokomish Tribe creating the Skokomish Indian Reservation [12 U.S. Stat. at Large 933; ratified and proclaimed 1859] is to be interpreted as including the lands here in controversy or not. If this treaty is to be given one construction then the rights asserted by the Skokomish Indian Tribe will be sustained. If it is to be given an opposite construction, the rights claimed will be defeated. This is the basis for deciding whether or not a federal question is involved. *Gully v. First National Bank*, 299 U.S. 109, 81 L.Ed 70. This is certainly the rule recognized in the cases cited by appellees themselves. *Martinez v. Southern Ute Tribe of Southern Ute Reservation*, 249 F.(2d) 915 (1957); *Phelps v. Hanson*, 163 F.(2d) 973 (1947); *Teeters v. Henton*, 43 F.(2d) 175 (1930).

The issue of treaty construction involved must affirmatively appear in the allegations of plaintiff's complaint. It has never been denied that the allegations of the complaint set forth in full the treaty construction problem involved and that the allegations are made in good faith. [Transcript of Record, pages 5 to 8 incl.]

We reiterate that the initial consideration of all the problems of this case must start from a construction of the treaty of 1855; and that that treaty may not be ignored in considering whether a federal question is herein involved. Such a treaty between the United States and an Indian tribe is a part of the supreme law of the land and cannot be treated by the courts as inoperative—or reformed by them. *Osage Tribe of Indians v. United States*, 66 Ct. Cl. 64 (1928). Such a treaty creates a binding obligation upon the United States and cannot be impaired. See 25 U.S.C. §71, *Moore v. United States*, 157 F.(2d) 760.

Where lands have been reserved for the use and occupation of an Indian tribe under the terms of a treaty or statute, the tribe must be compensated if the lands are subsequently taken from them. *Sioux Tribe of Indians v. United States*, 316 U.S. 317, 86 L.Ed. 1501 (1942); *Shoshone Tribe v. United States*, 299 U.S. 476, 81 L.Ed. 360, 57 Sup. Ct. 244.

In *Shulthis v. McDougall*, 225 U.S. 561, 56 L.Ed. 1205 (1912) no federal question was involved because

no controversy existed respecting the validity, construction or effect of the Constitution, a treaty, or a statute of the United States. The only thing shown was that the statutes involved were the source of the complainant's title or right, and the complaint did not make mention concerning a controversy respecting their construction or effect. This is exactly the opposite of the situation herein presented, where the treaty is set forth as the right under which appellant must fail or prevail, and not merely as a source of title.

In *Norton v. Larney*, 266 U.S. 511, 69 L.Ed. 413 (1925) a suit to quiet title involving Indian lands was challenged on the ground that no federal question was involved. The court pointed out that it appeared in the record that the suit arose under an act of Congress and the solution depended on the construction and effect of that act. The court states, in part:

“It thus appears that the right set up by appellees would be defeated by the construction of the act as appellants contend, but would be supported by the opposite construction. The case, therefore, in fact, is one arising under a law of the United States within the meaning of §24, subd. 1, of the Judicial Code.”

Indeed, the right of maintaining a suit arises pursuant to provisions of treaties with the Indian tribes. In fact, it has been held that when the right asserted is a federally-created right and a federal statute is invoked as the basis for the relief sought, then the district court has jurisdiction over the subject matter

and the parties. *Brown v. Stufflebean*, 187 F.(2d) 347 (1951); *Cohen, Federal Indian Law*, p. 329.

The construction of a similar treaty was involved in *United States v. Winans*, 198 U.S. 371, 25 Sup. Ct. 662 (1905). The court there states that the pivot of the controversy is the construction of the paragraph in the treaty which gave to the Yakima Indian Tribe the right of taking fish at all usual and accustomed places in common with the citizens of the territory. Because of the impact of that case we quote at length from it:

“The right to resort to the fishing places in controversy was a part of larger rights possessed by the Indians, upon the exercise of which there was not a shadow of impediment, and which were not much less necessary to the existence of the Indians than the atmosphere they breathed. New conditions came into existence, to which those rights had to be accommodated. Only a limitation of them, however, was necessary and intended, not a taking away. In other words, the treaty was not a grant of rights to the Indians, but a grant of right from them,—a reservation of those not granted. And the form of the instrument and its language was adapted to that purpose. Reservations were not of particular parcels of land, and could not be expressed in deeds, as dealings between private individuals. The reservations were in large areas of territory, and the negotiations were with the tribe. They reserved rights, however, to every individual Indian, as though named therein. They imposed a servitude upon every piece of land as though described therein. * * * It is further contended that the rights conferred upon the Indians are subordinate to the powers acquired by the state upon its admission into the

Union. In other words, it is contended that the state acquired by its admission into the Union 'upon an equal footing with the original states,' the power to grant rights in or to dispose of the shore lands upon navigable streams, and such power is subject only to the paramount authority of Congress with regard to public navigation and commerce. The United States, therefore, it is contended, could neither grant nor retain rights in the shore or to the lands under water.

"The elements of this contention and the answer to it are expressed in *Shively v. Bowlby*, 152 U.S. 1, 38 L.Ed. 331, 14 Sup. Ct. Rep. 548. It is unnecessary, and it would be difficult, to add anything to the reasoning of that case. The power and rights of the states in and over shore lands were carefully defined, but the power of the United States, while it held the country as a territory, to create rights which would be binding on the states, was also announced, opposing the *dicta* scattered through the cases, which seemed to assert a contrary view. * * *"

Thus, contrary to the contention of appellees, the right of the Skokomish Tribe to the tidelands reserved to them is paramount to any right of the state. The state's right was acquired subject to the primary treaty rights of the Skokomish and when in conflict therewith the state must acknowledge the supreme right and submit. While this argument is addressed to the merits it points up the existence of a federal question, the discovery of which cannot be made without some inquiry into the subject matter of this action.

United States v. Ashton, 170 Fed. 509 (1909) is relied upon by the appellees. In that case the factual

situation was materially different than here exists in relation to the Skokomish reservation. In the *Ashton* case the reservation had been extinguished, while in the instant case the reservation remains in full existence and use. See *United States v. Taylor*, 33 F.(2d) 608, 614 (1929); *Montana Power Company v. Rochester*, 127 F(2d) 189, 191 (1942). This court found that a federal question was involved in the interpretation of these treaties in *Mcauley v. Makah Indian Tribe*, 128 F.(2d) 867 (1942). We submit that this case presents a federal question and that the Federal District Court has jurisdiction of its solution.

B. THE REQUIRED JURISDICTIONAL AMOUNT IS INVOLVED IN THIS CASE.

The action here brought is one to quiet title. The complaint sets forth the allegations that the tidelands in question were reserved to the plaintiff tribe under the treaty. The complaint also relates that the State of Washington has granted certain rights to the defendants named in the complaint, or their predecessors in interest. Thus we find that the titles or claims of the defendants have a common source.

In *Peterson v. Sucro*, 93 F.(2d) 878 (1938) the court stated as follows:

“A plaintiff cannot, of course, invoke the federal jurisdiction where the requisite jurisdictional amount must be obtained by joining in one action separate claims against two or more defendants. [citing cases]. But ordinarily in suits

to quiet title or actions in ejectment, the amount in controversy is the value of the whole of the real estate to which the claim extends and not the value of defendant's claim." [citing cases].

In *Cornell v. Mabe*, 206 F.(2d) 514 (1953) a quiet title action was brought against 49 individuals who owned record title to lots derived from one common owner. In considering the motion to dismiss on the basis that the matter in controversy as to each defendant did not exceed the jurisdictional amount the court stated:

"It is true that where a suit is brought against several defendants asserting claims against each of them which are separate and distinct, the test of jurisdiction is the amount of each claim, and not their aggregate. However, when the action is to recover a single tract of land and the several defendants claim under a common source of title, the matter in controversy is the entire tract of land and not its several parts. The trial court properly overruled the defendants' plea to its jurisdiction."

All of the appellees who claim title to the land assert the common defense that the tidelands were not vested in the Skokomish Indian Tribe by virtue of the treaty of 1855. The allegations of the complaint make it plain that a common issue is raised as to all defendants and that a common source of title is involved.

It is the general rule, where several plaintiffs unite to enforce a single title or right in which they have a common undivided interest, that a jurisdictional amount is met when the interests collectively

total the requisite sum. *Century Insurance Company v. Mooney*, 241 F.(2d) 910 (1957); *Bateman v. Southern Ore Company*, 217 Fed. 933. We think the analogy holds true that here there is a single title or right of the Skokomish Tribe flowing from its treaty, the values of each of the tracts involved may be aggregated to reach the jurisdictional amount.

That sufficient value is involved was obvious to the district judge initially confronted with the problem and his statement in the memorandum opinion is well founded. (Transcript of Record, page 49). The Congress has seen fit to require a minimum sum to be in issue before federal jurisdiction lies in order to channel petty contest elsewhere, relieve the federal courts of unimportant matters, and define a manageable workload for the federal system. Certainly the sum involved here exceeds the jurisdictional minimum, the cause cannot be considered unimportant, and a consideration of its merits will not thwart the Congressional purpose.

The foregoing is in reply to the contentions of the United States, the State of Washington, and the private appellees, each of whom challenges the jurisdiction of the Federal Courts to hear this cause.

II. REPLY TO UNITED STATES: THE UNITED STATES IS A NECESSARY, BUT NOT AN INDISPENSABLE PARTY TO THIS ACTION.

The United States contends that under *Choctaw*

and Chickasaw Nations v. Seitz, 193 F.(2d) 456 (1951), the United States cannot be joined herein even though a necessary party, since it has not consented to be sued. Our interpretation of that case differs from that of the United States. We submit that the *Seitz* case stands for the proposition that permission to sue may be conferred by *implication* by statute, but that if such an implication cannot be fairly drawn from the statute, consent is lacking. We submit that an examination of the treaty with the S'klallams entered into in 1855 [12 U.S. Stat. at Large 933] in the light of our government's historical relationship with Indian tribes pursuant to such treaties as discussed at pages 7 to 29 of our opening brief, discloses that the United States has assumed obligations and entered upon a relationship which implies consent to be sued in a matter such as this, particularly where no claim adverse to the United States is asserted.

We contended in our opening brief that the United States is not an indispensable party and are glad to note that the government concurs in this position and urges reversal insofar as the District Court held the United States to be an indispensable party. (Brief for the United States, pages 6-7). We submit that it should be held to be a necessary party, within the rule of the *Seitz* case and the cases following it, and should be joined as such in view of the treaty here in issue and the obligations assumed thereby, from which con-

sent to assume its responsibility as guardian of its Indian wards can be implied. But in any event, since the United States is not an indispensable party, the case may proceed without its being joined and it was error to dismiss the action as to the other defendants. *Choctaw and Chickasaw Nations v. Seitz, supra; United States v. Candelaria*, 271 U.S. 432, 70 L.Ed. 1023 (1926).

In other words, appellant is not here seeking to assert any interest adverse to the United States and asks for no relief against it. The tribe merely seeks to call the United States to a performance of its obligations, asking the government's assistance in the preservation of its treaty rights—and originally did so, in fact, at the suggestion of the District Judge. (Transcript of the Record, Pages 122 to 124). If the United States, acting through the Attorney General, declines to accept its responsibilities and insists upon its immunity to suit, it may be—contrary to our contentions above—that neither appellant nor the court can compel the United States to appear. Appellant agrees that if that is the outcome, the United States will not be bound by a judgment in this proceeding, but that was also true in the *Candelaria* and *Seitz* cases, *supra*. Having tendered the case to the United States, however, it is clear, under those cases, that appellant is entitled to proceed against the other appellees even though the United States is not a party.

III. REPLY TO APPELLEE STATE OF WASHINGTON: THE STATE HAS CONSENTED TO BE SUED.

Counsel for the State of Washington have urged at some length their very broad views with respect to the state's immunity from suit. At page 15 of their brief they state their position in its most extreme form by claiming "immunity from suit in any court"—a statement which is unsound on its face. They make only passing reference to Section 194, c.255, Laws of 1927, RCW 79.01.736 (formerly RCW 79.08.020). At page 17 it is stated that this statute "does not waive the state's immunity from suit nor authorize any state officer to do so."

This section was part of an extensive statute dealing with the public lands of the state, specifically including tidelands. Section 194 not only authorizes the Attorney General to defend actions to which the state may be a party in any court of the United States but imposes the duty upon him to do so. Clearly the legislature did not intend the enactment of this provision to be a useless act. The legislature is empowered to permit the state to be sued. By this provision it has recognized the state's suability in the federal courts and by the clearest possible inference has consented thereto. It would certainly be presumptuous to suggest that the legislature intended to direct the Attorney General to defend suits in courts in which

it had not, in so doing, consented that the state might be sued.

The cases cited by counsel for the state at pages 16 to 18 of the brief are not in point here because none of them involved a statute similar to RCW 79.01.736. The Attorney General appeared in this case, involving a subject matter with respect to which he is authorized to represent the state and before a court clearly contemplated by the legislature. The state has consented to be sued in the District Court in matters of this kind.

In like manner, counsel for the state make little mention in its brief of the provisions of the Organic Act creating the territorial government of Washington [10 U.S. Stat. at Large, c.90 p. 172], wherein it is provided that the United States shall be free to make any regulation respecting the Indians of the territory, their lands, property or other rights by treaty, law or otherwise, which the United States would have been competent to make in the first instance; nor do they discuss the consent to be sued which was required of it by Section 4 of the Enabling Act creating the state [25 U.S. Stat. at Large, c.180 p. 676]. Similarly, no discussion is offered of the provisions of Art. XXVI of the Washington State Constitution which complies with the requirements of the Enabling Act, disclaiming all right to lands held by the Indian tribes and consenting to the jurisdiction of

the United States over said lands. For the convenience of the court we set Art. XXVI of the Washington State Constitution forth in the appendix. The passage of time has not impaired the full force of this binding consent of the citizens of the State of Washington to suit in federal court in cases such as this, where tribal lands are concerned. The force of a treaty overrides state statutes and must be regarded as a part of an individual state's own law. It may override the power of the state even in respect to a great breadth of private relationships which usually fall within the control of the state. *Amaya v Stanolind Oil & Gas Co.*, 158 F.(2d) 554. While it is true that before statehood the United States held title to all land now within the boundaries of the state in trust for the future state, it nevertheless is also true that the power existed in the United States to patent lands and to set certain lands aside by treaty to the Indian tribes. The state recognized, and indeed was forced to recognize, such prior conveyances and to disclaim all title to such land as a condition of statehood. *Mercer Island Beach Club v. Pugh*, 153 Wn. Dec 421 (1959); *Narrows Realty Company, Inc. v. State*, 152 Wn. Dec. 788 (1958). The citizens of the State of Washington consented to suit for the protection of these tribal lands in consideration of the granting of statehood, and the passage of time has not lessened the binding quality of this consent or the obligation of the state to recognize it.

The exigencies of the present are a poor excuse for the breach of treaty commitments once honored as sacred. Blumenthal, *American Indians Dispossessed*, Pg. 167.

CONCLUSION

We submit that the proper decision of this case must be one based upon the specific relationship between the Skokomish Indian Tribe, growing out of its treaty with the United States, and the appellees herein. Arguments involving relationships which are not parallel to the instant case and which overlook the fact that the treaty with the S'klallams, the Organic Act, the Enabling Act and the Washington State Constitutional provision stand on as firm a foundation as they did at the time of their execution, are necessarily fallacious. We submit that the jurisdiction of the federal court is firmly established. We submit further, that the United States is a necessary party and, for convenience and good conscience, should be brought into this action; but we concede that it is not an indispensable party and urge most strongly that, in any event, the case can proceed without it.

The State of Washington consented, as a condition to statehood, to the imposition of obligations in favor of the Indians in connection with their lands which must necessarily be triable in the federal courts, all jurisdiction having been reserved to the United States.

Similarly, the state has expressly recognized by statute that it may be sued in the federal courts and has authorized and directed its Attorney General to appear therein—as he has done in this case. In any event, as with respect to the United States, dismissal of the state does not prevent proceeding as against the private defendants.

As to the individual and corporate defendants, no real reason for dismissing the action has been suggested. They enjoy no immunity from suit, and the appellant's dispute with them clearly arises under its treaty with the United States and involves more than \$3,000.00. Under the Enabling Act and the State Constitution jurisdiction over the lands here involved has been reserved to the United States. Even if it be held that the District Court does not have jurisdiction of the United States and the state, it clearly has jurisdiction of the other parties and should proceed as to them.

We respectfully submit that the Order of Dismissal of the District Court should be reversed and the District Court instructed to proceed to trial upon the merits of the case.

Respectfully submitted,

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APPENDIX

Washington State Constitution

Article XXVI COMPACT WITH THE UNITED STATES

“ * * * Second. That the people inhabiting this state do agree and declare that they forever disclaim all right and title to the unappropriated public lands lying within the boundaries of this state, and to all lands lying within said limits owned or held by any Indian or Indian tribes; and that until the title thereto shall have been extinguished by the United States, the same shall be and remain subject to the disposition of the United States, and said Indian lands shall remain under the absolute jurisdiction and control of the congress of the United States and that the lands belonging to citizens of the United States residing without the limits of this state shall never be taxed at a higher rate than the lands belonging to residents thereof; and that no taxes shall be imposed by the state on lands or property therein, belonging to or which may be hereafter purchased by the United States or reserved for use: *Provided*, That nothing in this ordinance shall preclude the state from taxing as other lands are taxed any lands owned or held by any Indian who has severed his tribal relations, and has obtained from the United States or from any person a title thereto by patent or other grant, save and except such lands as have been or may be granted to any Indian or Indians under any act of congress containing a provision exempting the lands thus granted from taxation, which exemption shall continue so long and to such an extent as such act of congress may prescribe. * * * ”

No. 16009 ✓

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

FRED DWIGHT JONES,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF OF APPELLEE.

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TOPICAL INDEX

PAGE

I.

Jurisdiction and statement of the case.....	1
---	---

II.

The arguments advanced by appellant have been considered and rejected by this honorable court and no valid reason for departing from the established rules has been advanced.....	1
A. The sentence is not ambiguous.....	1
B. Consecutive sentences must be aggregated.....	2
C. Section 1324 of Title 8 is constitutional.....	3
D. Congress provided a separate penalty for each alien trans- ported	4
Conclusion	5

TABLE OF AUTHORITIES CITED

CASES	PAGE
Grant v. Hunter, 166 F. 2d 673.....	2
Herrera v. United States, 208 F. 2d 215.....	4
Hurst v. Zarter, et al., 195 F. 2d 526.....	2
Martinez-Quiraz v. United States, 210 F. 2d 763.....	4
Sepulveda v. Squier, 192 F. 2d 796.....	3, 4
Serentino, et al. v. United States, 36 F. 2d 871.....	3
Staley v. United States, F. 2d (9th Cir., 1958), decided June 25	2
United States v. Evans, 333 U. S. 483.....	3, 4, 5
United States v. Howell, 103 Fed. Supp. 714, aff'd 199 F. 2d 366	2
United States ex rel. Johnson v. O'Donovan, 178 F. 2d 810.....	2
Vega-Murrillo v. United States, 247 F. 2d 735.....	4

STATUTES

39 Statutes at Large, p. 808.....	3
66 Statutes at Large, p. 228.....	4
United States Code, Title 8, Sec. 144.....	3, 4, 5
United States Code, Title 8, Sec. 1324	3, 4
United States Code, Title 8, Sec. 1324(a) (2)	1

No. 16009

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

FRED DWIGHT JONES,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF OF APPELLEE.

I.

Jurisdiction and Statement of the Case.

The Government accepts the jurisdictional statement and the statement of the case made by appellant.

II.

The Arguments Advanced by Appellant Have Been Considered and Rejected by This Honorable Court and No Valid Reason for Departing From the Established Rules Has Been Advanced.

A. The Sentence Is Not Ambiguous.

Appellant was convicted on four counts charging the illegal transportation of aliens within the United States in violation of Title 8, United States Code, Section 1324(a)(2), and sentenced to a term of five years on

each of Counts One and Two, these sentences to run concurrently, and to a term of one year on each of Counts Three and Four, said one year sentences to run concurrently with each other but consecutive to the sentence imposed on Counts One and Two. [Clk. Tr. pp. 6-7.] His initial argument is that the sentence is ambiguous and cannot reasonably be interpreted. That such an argument is patently frivolous has very recently been pointed out by this Honorable Court (*Staley v. United States*, F. 2d (9th Cir., 1958), decided June 25).

B. Consecutive Sentences Must Be Aggregated.

Appellant elaborates on the foregoing argument by asserting that the sentences prejudiced him in the computation of allowance for good time. It is, however, well settled that consecutive sentences are totalled for the purpose of computing the allowance for good time.

Hurst v. Zarter, et al., 195 F. 2d 526 (10th Cir., 1952);

United States ex rel. Johnson v. O'Donovan, 178 F. 2d 810 (7th Cir., 1949);

Grant v. Hunter, 166 F. 2d 673 (10th Cir., 1948).

A similar argument has been advanced with respect to appellant's eligibility for parole. The answer is the same, to-wit: consecutive sentences are totalled in determining a prisoner's eligibility for parole. (See: *United States v. Howell*, 103 Fed. Supp. 714 (U. S. D. C., S. D., W. Va., 1952), affirmed 199 F. 2d 366 (4th Cir., 1952).)

C. Section 1324 of Title 8 Is Constitutional.

Succinctly stated, the position advocated in appellant's brief is that since the sentences imposed on Counts Three and Four are directed to run consecutively to those on Counts One and Two, he will spend a greater period of time incarcerated than if the sentences were all made to run concurrently. This argument alone is obviously of no merit. However, there is an attempt to reinforce this position by challenging the validity of the penalty provision contained in Section 1324 of Title 8, United States Code, on the ground that it is unconstitutional to prescribe a separate punishment for each and every alien concerned in a violation of Section 1324, Title 8, United States Code. The Government's answer to this point is that it has been considered and rejected by this very Court in *Sepulveda v. Squier*, 192 F. 2d 796 (9th Cir., 1951). See also: *Serentino, et al. v. United States*, 36 F. 2d 871 (1st Cir., 1930). It should be noted that the *Sepulveda* case, *supra*, was decided under the predecessor of the statute under which appellant was prosecuted, the earlier enactment being Section 144 of Title 8, United States Code, 39 Stat. 808. This section was declared unconstitutional by the Supreme Court in *United States v. Evans*, 333 U. S. 483 (1948). The decision in the *Evans* case, however, was limited to the point of deciding that Congress simply failed to provide a penalty for harboring and concealing aliens who were illegally in the United States. The statute at that time provided penal sanctions only for landing or bringing in aliens.

Furthermore, the decision in the *Evans* case, after discussing the penalty clause, noted: "The clause's function was solely to augment the penalty when more than one alien was involved." 333 U. S. 483, 494. The *Sepulveda* case was decided subsequent to the *Evans* case and involved four counts of bringing aliens into the United States. After those two decisions, Section 144 of Title 8, United States Code, was amended. It is now Title 8, Section 1324, 66 Stat. 228. The successor provision has been found constitutional.

Herrera v. United States, 208 F. 2d 215 (9th Cir., 1953);

Martinez-Quiraz v. United States, 210 F. 2d 763, (9th Cir., 1954).

It is this statute under which appellant in the instant case was prosecuted.

D. Congress Provided a Separate Penalty for Each Alien Transported.

Appellant's argument that there was a single transaction for which only one penalty could be imposed is contrary to the law. He cites Mann Act cases in support of this theory. The identical argument was rejected by this Court in a case involving Section 1324 of Title 8, United States Code.

Vega-Murrillo v. United States, 247 F. 2d 735, 737-738 (9th Cir., 1957).

In summary the Government respectfully submits that *Sepulveda v. Squier* and *Vega-Murrillo v. United States* are dispositive of the argument advanced by appellant

and the authority of those cases is in no way impinged upon by the *Evans* decision, *supra*, which turned solely on a legislative oversight in Section 144 of the *old* Title 8, United States Code, but which implicitly approved of the penalty provision being made proportionate to the number of aliens involved.

Conclusion.

For the foregoing reasons it is respectfully submitted that the decision of the District Court be affirmed.

LAUGHLIN E. WATERS,
United States Attorney,

LLOYD F. DUNN,
*Assistant U. S. Attorney,
Chief, Criminal Division,*

PETER J. HUGHES,
*Assistant U. S. Attorney,
Attorneys for Appellee.*

No. 16010 ✓

United States
Court of Appeals
for the Ninth Circuit

GENE O. CLARK and FAYE CLARK,
Petitioners,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

In Two Volumes
VOLUME I.
(Pages 1 to 280, inclusive)

Petition to Review a Decision of The Tax
Court of the United States

FILED

AUG 22 1958

PAUL P. O'BRIEN, CLERK

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GENE O. CLARK and FAYE CLARK,
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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	PAGE
Amendment to Petition for Redetermination of Deficiency (Docket Nos. 48542-3)	25
Answer to Amendment to Petition for Redetermination of Deficiency:	
Docket No. 48542	26
Docket No. 48543	45
Answer to Petition for Redetermination of Deficiency:	
Docket No. 48542	16
Docket No. 48543	36
Certificates of Clerk to Transcript of Record	175, 177
Computation for Entry of Decision:	
Docket No. 48542	145
Docket No. 48543	152
Decision:	
Docket No. 48542	160
Docket No. 48543	161
Docket Entries:	
Docket No. 48542	3
Docket No. 48543	6

ii.

Memorandum Findings of Fact and Opinion (Docket Nos. 48542-3-4)	52
Minutes of Proceedings (Docket Nos. 48542-3-4)	46
Motion to Amend Petition for Redetermination of Deficiency:	
Docket No. 48542	23
Docket No. 48543	43
Notice of Filing Petition for Review (Docket Nos. 48542-3)	171
Names and Addresses of Attorneys	1
Opinion (Docket Nos. 48542-3-4)	83,
Petition for Redetermination of Deficiency (Docket No. 48542)	6
Exhibit A—Notice of Deficiency	10
Petition for Redetermination of Deficiency (Docket No. 48543)	27
Exhibit A—Notice of Deficiency	30
Petition for Review:	
Docket No. 48542	162
Docket No. 48543	166
Reply to Answer to Petition for Redetermina- tion:	
Docket No. 48542	22
Docket No. 48543	42
Statement of Points on Which Petitioners Will Rely (USCA)	518

iii.

Stipulation of Facts (Docket Nos. 48542-3-4)	172
Stipulation re Printing of Exhibits (USCA)	522
Stipulation re Testimony of Donald E. Phillips	176
Transcript of Proceedings of March 30-31, April 1, 1955 (Docket Nos. 48542-3-4) . . .	178

Witnesses for Petitioners:

Clark, Gene O.

—direct	315, 343
—cross	353
—redirect	385, 393
—recross	391
—recalled, direct	401
—recross	434

Claypoole, Paris B.

—direct	179
—cross	208

Witnesses for Respondent:

Bittinger, Frances B.

—direct	229
-------------------	-----

Creed, Y. L.

—direct	213
-------------------	-----

Files, Frederick W.

—direct	240
—cross	260
—redirect	281, 287
—recross	285

Transcript of Proceedings—(Continued):

Witnesses for Respondent—(Continued):

Johnson, Truman

—direct 220

—cross 224

Lang, Ben

—direct 227

Meissenburg, Lloyd George

—direct 232

—cross 235

—redirect 239

Phillips, Donald

—direct 287

—cross 302

Stutzman, Kenneth S.

—direct 394

—cross 397

Transcript of Testimony of March 29-30, 1955

(Docket Nos. 48336-7-8) 435

Witnesses for Respondent:

Phillips, Donald E.

—direct 435

—cross 456

—redirect 508

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The Tax Court of the United States

Docket No. 48542

GENE O. CLARK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1953

May 18—Petition received and filed. Taxpayer notified. Fee paid.

May 20—Copy of petition served on General Counsel.

May 18—Request for Circuit hearing in Kansas City, Mo. filed by taxpayer. 5/25/53 granted.

May 18—Notice of appearance of Walter L. McVey, Jr. as counsel filed.

July 20—Motion for extension to Aug. 20, 1953 to file answer filed by G. C. 7/21/53 granted.

Aug. 18—Answer filed by G. C.

Aug. 25—Copy of answer served on taxpayer, Kansas City.

Oct. 1—Motion for extension of time to 11/2/53 to file reply, filed by taxpayer. Granted.

Nov. 2—Reply to answer filed by taxpayer. Copy served.

1954

Aug. 17—Motion to change place of hearing to Los Angeles, Calif. filed by taxpayer. 8/20/54 granted.

1954

Aug. 17—Motion to withdraw Walter L. McVey, Jr., as counsel filed. 8/20/54 granted.

Nov. 24—Hearing set Jan. 10, 1955, Los Angeles.

1955

Jan. 10 & 12—Hearing had before Judge Raum on petr's. motion for continuance. Motion for continuance granted, served and appearances of Thomas A. Baird and Alva C. Baird filed at hearing.

Jan. 21—Hearing set March 21, 1955, Los Angeles, Calif.

Jan. 24—Transcript of hearing 1/12/55 filed.

Mar. 28, 30 & 31—Hearing had before Judge Fisher & Apr. 1—on the merits on Petr's. oral motion to consolidate dkts. 48542, 48543 and 48544, granted; on Respdt's oral motion to amend pleadings—taken C.A.V. and on Petr's. written motion to amend petition, granted. Respdt. given 30 days (5/2/55) to reply.

Stip. of facts: memorandum re Plea of Nolo Contendere; Motion to amend petition and amendment to petition (copies served), filed at hearing. Briefs 6/30/55 and Replies 8/1/55.

Apr. 18—Transcript of hearing 3/30/55 filed.

May 3—Transcript of hearing 3/28/55 filed.

Apr. 25—Transcript of hearing 3/31/55 filed.

Apr. 28—Answer to amendment to petition filed by G. C. 4/29/55 copy served.

1955

May 3—Transcript of hearing 4/1/55 filed.

Jun. 27—Motion for extension to Aug. 29, 1955 to file brief filed by G. C. 6/28/55 granted.

Aug. 24—Motion for extension of time to Oct. 13, 1955 to file brief, filed by G. C. 8/25/55 granted.

Sep. 26—Brief filed by taxpayer. 11/4/55 copy served.

Oct. 11—Motion for extension to Nov. 3, 1955 to file brief filed by G. C. 10/12/55 granted.

Nov. 3—Brief filed by G. C. Served 11/4/55.

Nov. 28—Motion for extension to Jan. 2, 1956 to file reply brief filed by respondent. 11/30/55 granted.

Dec. 1—Motion for extension to Jan. 18, 1956 to file reply brief filed by taxpayer. 12/1/55 granted.

1956

Jan. 17—Reply brief filed by taxpayer. 1/18/56 copy served.

1957

July 17—Memorandum findings of fact and opinion filed, Fisher, J. Decision will be entered under Rule 50. Served 7/17/57.

Nov. 13—Agreed computation filed.

Nov. 20—Decision entered, Judge Fisher. Served 11/21/57.

1958

Feb. 10—Petition for review by U. S. Ct. of Ap. 9th filed by Petr.

1958

Feb. 14—Designation of contents of record on review filed.

Feb. 17—Acknowledgment of service of designation filed.

Feb. 17—Proof of service of petition for review filed.

Mar. 3—Order extending time for filing record on review and docketing pet. for review to May 11, 1958.

The Tax Court of the United States

Docket No. 48543

FAYE CLARK, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

[Note: Docket Entries in No. 48543 are the same as in Docket No. 48542 set out at page 3 of this printed record.]

[Title of Tax Court and Docket No. 48542.]

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols A:R:90D:LHP) dated

February 20, 1953, and as a basis for his proceeding alleges as follows:

1. The petitioner is an individual with residence at Clark's Buffalo Ranch, Independence, Kansas. During the years 1945, 1946 and 1947, petitioner was a resident of the State of California and the returns for the periods here involved were filed with the Collector of Internal Revenue at Los Angeles, California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to petitioner on February 20, 1953.

3. The deficiency as determined by the Commissioner is in income taxes for the calendar years 1945, 1946 and 1947 in the amount of \$24,955.42, with a penalty of \$12,477.72, making a total of \$37,433.14, all of which amount is in controversy.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner has erroneously assessed tax deficiencies for the years 1945, 1946 and 1947 more than three years after the returns were filed, contrary to the provisions of section 276 (a) of the Internal Revenue Code.

(b) The Commissioner has erroneously assessed tax deficiencies for the years 1945 and 1946 more than five years after the returns were filed, contrary to the provisions of section 276 (c) of the Internal Revenue Code.

(c) The Commissioner has erroneously added to the deficiency a penalty in the amount of \$12,477.72.

(d) No grounds or reasons are stated by the Commissioner for assessing the tax deficiencies beyond the period of limitation or for asserting the penalty in the amount of \$12,477.72. The petitioner contends that there was no intent to evade payment of income taxes for the years 1945, 1946 and 1947.

(e) In determining the taxable net income of the petitioner for the year 1946, the Commissioner has erroneously determined that petitioner received taxable dividends from Gene Clark, Inc., in the amount of \$44,227.13, petitioner's one-half under California Community Property Law being \$22,113.56, which it is alleged he failed to report in his income tax return for the calendar year 1946.

(f) In determining the taxable net income of the petitioner for the year 1947, the Commissioner has erroneously determined that petitioner received taxable dividends from Gene Clark, Inc., in the amount of \$49,500.99, petitioner's one-half under California Community Property Law being \$24,750.50, which it is alleged he failed to report in his income tax return for the calendar year 1947.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) That to the best of petitioner's knowledge, the corporation of Gene Clark, Inc., paid out of its earned surplus only one legally declared dividend to petitioner. This dividend was in the amount of \$19,996.17, paid on or about April 30, 1948, and was reported by petitioner as taxable income in his tax return for that calendar year.

6. The petitioner is without adequate knowledge

or facts, at this time, to defend himself against the contentions of the Commissioner for the deficiency assessed for the years 1946 and 1947 for the following reasons:

(a) Petitioner's personal records, books of account, receipts, cancelled checks, check stubs, and deposit slips for the years 1946 and 1947 were delivered into the hands of a representative of The Bureau of Internal Revenue residing in Rosemead, California, by the name of Earl Stutzman, who petitioner believes examined said records upon the basis of an informer's report in order to determine whether or not any deficiencies existed in connection with petitioner's income tax returns filed these years. These records were delivered into the possession of the said Earl Stutzman and were examined by the said Earl Stutzman during the months of January, February and March, 1949. Upon completion of his examination of petitioner's income tax returns for these years, the said Earl Stutzman made a "no-change" report. None of these personal records were ever returned to petitioner.

(b) Petitioner has been unable to have access to or to examine the corporate records of Gene Clark, Inc., in their entirety since he received notice of deficiency. After receiving notice of deficiency, petitioner made a trip to California with his attorney for the purpose of obtaining or examining the complete records of Gene Clark, Inc., in connection with this case; however, petitioner was denied this right.

(c) Petitioner has reason to believe that certain

possible witnesses for petitioner have been intimidated.

(d) The notice of deficiency is insufficient to inform petitioner wherein Commissioner's contentions lie in respect to unreported dividends allegedly received by petitioner.

7. In redetermining petitioner's tax liability for the year 1947, petitioner claims a loss from farm operations in the amount of \$4,199.81, which loss was not claimed on petitioner's tax return filed for that year.

Wherefore, petitioner prays that this Court may hear the proceeding and redetermine the tax of petitioner for the years 1945, 1946 and 1947 and any deficiency which may be due from petitioner for those years.

/s/ GENE O. CLARK,
Petitioner.

Duly Verified.

EXHIBIT "A"

Form 1234

U. S. Treasury Department
Office of the Director of Internal Revenue, Head,
Audit Division, 417 South Hill Street, Los
Angeles 13, California.

Feb. 20, 1953

In replying refer to: A:R:90D:LHP

Mr. Gene O. Clark

c/o Clark's Buffalo Ranch, Independence, Kansas

Dear Mr. Clark:

You are advised that the determination of your

Exhibit "A"—(Continued)

income tax liability for the taxable years ended December 31, 1945, 1946 and 1947, discloses a deficiency of \$24,955.42 and \$12,477.72 in penalty, as shown in the statement attached. Assessment of such deficiency or deficiencies has been made under the provisions of the internal revenue laws applicable to jeopardy assessments.

In accordance with the provisions of existing internal revenue laws notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Very truly yours,

T. COLEMAN ANDREWS,
Commissioner,

/s/ By R. A. RIDDELL,
Director.

Enclosures:

Statement
Form 1276

Exhibit "A"—(Continued)

Statement

A:R:90D:LHP

Mr. Gene O. Clark
c/o Clark's Buffalo Ranch
Independence, Kansas

Tax Liability for the Taxable Years Ended December 31, 1945, December 31, 1946 and December 31, 1947.

Summary of Deficiencies

Year		Deficiency	50% Penalty
1945	Income tax	\$ 803.89	\$ 401.95
1946	Income tax	12,052.82	6,026.41
1947	Income tax	12,098.71	6,049.36
Totals		\$24,955.42	\$12,477.72

Summary of assessments made under the provisions of Internal Revenue laws applicable to jeopardy assessments, on December 24, 1952, for the taxable years ended December 31, 1945, December 31, 1946 and December 31, 1947.

Year	Deficiency	50% Penalty	Interest Due 12-24-52
1945	Income tax \$ 803.89	\$ 401.95	\$ 326.76
1946	Income tax 12,052.82	6,026.41	4,176.05
1947	Income tax 12,098.71	6,049.36	3,466.03
Totals		\$24,955.42	\$12,477.72
			\$7,968.84

This determination of your income tax and penalty liability has been made upon the basis of information on file in this office.

The 50 per cent penalty shown herein has been asserted in accordance with the provisions of section 293(b) of the Internal Revenue Code.

Adjustments to Net Income

Taxable Year Ended December 31, 1945

Net income as disclosed by return		\$5,504.71
Additional income and unallowable deduction:		
(a) Net profit from business increased	\$2,500.00	
(b) Net loss from sale of property		
other than capital assets disallowed	177.87	2,677.87
	<hr/>	<hr/>
Net income adjusted		\$8,182.58

Exhibit "A"—(Continued)

Explanation of Adjustments

(a) It has been determined that you realized a net profit of \$17,365.16 from operation of your business, in lieu of \$12,365.16, the amount reported in your return, an increase of \$5,000.00, your community half of which is \$2,500.00.

(b) The deduction of \$355.75 claimed from the sale of property other than capital assets is disallowed. It has been determined that the property sold was your personal automobile, the loss from the sale of which is not an allowable deduction. Your community half of the amount disallowed is \$177.87.

Computation of Tax

Taxable Year Ended December 31, 1945

Net income adjusted	\$8,182.58	
Less: Surtax exemptions	1,500.00	
	<hr/>	
Surtax net income	\$6,682.58	
Surtax		\$1,564.77
Net income adjusted	\$8,182.58	
Less: Normal-tax exemption	500.00	
	<hr/>	
Net income subject to normal tax	\$7,682.58	
Normal tax at 3%		\$ 230.48
Correct income tax liability		\$1,795.25
Income tax liability shown on return, account No. 3051314		991.36
		<hr/>
Deficiency of income tax		\$ 803.89
50% Penalty		\$ 401.95

Adjustments to Net Income

Taxable Year Ended December 31, 1946

Net income as disclosed by return	\$14,651.67
Additional income:	
(a) Dividends unreported	22,113.56
	<hr/>
Net income adjusted	\$36,765.23

Explanation of Adjustments

(a) It has been determined that you received taxable dividends from Gene Clark, Inc., in the amount of \$44,227.13, your one-half \$22,113.56, which you failed to report in your income tax return for the calendar year 1946.

Exhibit "A"—(Continued)

Computation of Tax

Taxable Year Ended December 31, 1946

Net income adjusted	\$36,765.23
Less: Exemptions	1,500.00
Balance, subject to surtax and normal tax	\$35,265.23
Tentative tax	\$16,582.40
Less 5%	829.12
Correct income tax liability	\$15,753.28
Income tax liability shown on return, account No. 3039848	\$ 3,700.46
Deficiency of income tax	\$12,052.82
50% Penalty	\$ 6,026.41

Adjustments to Net Income

Taxable Year Ended December 31, 1947

Net income as disclosed by return	\$ 9,130.51
Additional income:	
(a) Dividends unreported	24,750.50
Total	\$33,881.01
Reduction of income:	
(b) Long-term capital gain decreased	99.80
Net income adjusted	\$33,781.21

Explanation of Adjustments

(a) It has been determined that you received taxable dividends from Gene Clark, Inc., in the amount of \$49,500.99, your one-half \$24,750.50, which you failed to report in your income tax return for the calendar year 1947.

(b) It has been determined that a long-term capital gain of \$105.15 was realized by you from the sale of a residence acquired in November, 1946, in lieu of \$304.75, the amount reported in your return, a decrease of \$199.60, your community half of which is \$99.80.

Exhibit "A"—(Continued)

Computation of Alternative Tax
Taxable Year Ended December 31, 1947

Net income adjusted	\$33,781.21
Less: Excess of net long-term capital gain over net short-term capital loss	530.71
Ordinary net income	\$33,250.50
Less: Exemptions	1,500.00
Balance, subject to surtax and normal tax	\$31,750.50
Total tentative tax	\$14,305.31
Less 5%	715.27
Partial tax	\$13,590.04
Plus: 50 per cent of \$530.71	265.36
Alternative tax	\$13,855.40

Computation of Tax
Taxable Year Ended December 31, 1947

Net income adjusted	\$33,781.21
Less: Exemptions	1,500.00
Balance, subject to surtax and normal tax	\$32,281.21
Total tentative tax	\$14,642.79
Less 5%	732.14
Total normal tax and surtax	\$13,910.65
Alternative tax	\$13,855.40
Correct income tax liability	\$13,855.40
Income tax liability shown on return, account No. 3050798	\$ 1,756.69
Deficiency of income tax	\$12,098.71
50% Penalty	\$ 6,049.36

Served May 20, 1953.

[Endorsed]: T.C.U.S. Filed May 18, 1953.

[Title of Tax Court and Docket No. 48542.]

ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, Kenneth W. Gemmill, Acting Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in the above-entitled proceeding, admits, denies, alleges, and avers as follows:

1. Admits the allegations of paragraph 1.

2. Admits the allegations of paragraph 2.

3. Admits the deficiencies as determined by the Commissioner are in income taxes and penalties for the calendar years 1945, 1946, and 1947. Denies the remaining allegations of paragraph 3. Avers the deficiencies in income tax and penalties as shown in the notice of deficiency are as follows:

Year	Deficiency	50% Penalty
1945 Income tax	\$ 803.89	\$ 401.95
1946 Income tax	12,052.82	6,026.41
1947 Income tax	12,098.71	6,049.36
	<hr/>	<hr/>
	\$24,955.42	\$12,477.72

4. (a) to (f), inclusive. Denies the allegations of error of paragraph 4 (a) to (f), inclusive.

5. (a) Denies the allegations of paragraph 5 (a).

6. (a) Denies the allegations of paragraph 6 (a).

(b) Denies the allegations of paragraph 6 (b).

(c) Denies the allegations of paragraph 6 (c).

(d) Denies the allegations of paragraph 6 (d).

7. Denies the allegations of paragraph 7.

8. Denies generally and specifically each and

every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

9. Further answering the petition, respondent affirmatively alleges that petitioner is liable for the 50 per cent fraud penalties imposed under the provisions of section 293(b) of the Internal Revenue Code for the taxable years 1945, 1946, and 1947 in the respective amounts of \$401.95, \$6,026.41, and \$6,049.36, as determined by the Commissioner and set forth in the notice of deficiency, a copy of which is attached to the petition. In support of the Commissioner's determination of the fraud penalties as set forth in said notice of deficiency respondent alleges as follows:

(a) During the taxable years 1945, 1946, and 1947 petitioner was married to Faye Clark and they lived together as husband and wife and were residents of the State of California.

(b) The petitioner caused to be prepared and filed with the Collector of Internal Revenue for the Sixth District of California his federal income tax returns for the taxable years 1945, 1946, and 1947 and represented that each of such returns was a true, correct, and complete return.

(c) In truth and in fact each of said income tax returns filed by petitioner for the taxable years 1945, 1946, and 1947 was false and fraudulent. The petitioner's net taxable income and the resulting income tax due thereon were understated in each such return as follows:

Year	Net Income Reported by Petitioner	Tax Liability Reported by Petitioner	Petitioner's Actual Net Income	Petitioner's Correct Tax Liability
1945	\$ 5,504.71	\$ 991.36	\$ 8,182.58	\$ 1,795.25
1946	14,651.67	3,700.46	36,765.23	15,753.28
1947	9,130.51	1,756.69	33,781.21	13,855.40

(d) At the time the aforesaid income tax returns for the taxable years 1945, 1946, and 1947 were prepared and filed the petitioner knew that such returns were false and fraudulent and that the amount of the taxable net income reported therein and the resultant tax liability shown thereon were understated in each of said returns. The petitioner knowingly, willfully, and fraudulently made and filed his federal income tax returns for the taxable years 1945, 1946, and 1947 with intent to deceive respondent and evade tax.

(e) During the taxable years 1945, 1946, and 1947 petitioner derived and received taxable income from a plumbing contracting business and/or dividend income from Gene Clark, Inc., which he failed to report for federal income tax purposes.

(f) On his income tax return for 1945 petitioner reported net income of \$5,504.71 whereas his correct net income for 1945 was \$8,182.58. The understatement of net income for 1945 consisted of unreported net income from his plumbing contracting business and the overstatement of a claimed deduction for a net loss from the sale or exchange of a Packard automobile.

(g) On his income tax return for 1946 petitioner reported net income of \$14,651.67 whereas his cor-

rect net income for 1946 was \$36,765.23. The understatement of net income for 1946 consisted of unreported taxable dividend distributions received by petitioner from Gene Clark, Inc.

(h) On his income tax return for 1947 petitioner reported net income of \$9,130.51 whereas his correct net income for 1947 was \$33,781.21. The understatement of net income for 1947 consisted of unreported taxable dividend distributions received by petitioner from Gene Clark, Inc. In determining the deficiency for 1947 the Commissioner reduced petitioner's taxable income by the sum of \$99.80 representing his community share of the overstatement of a long-term capital gain realized from the sale of a residence.

(i) The understatement of net income and income tax liability for each of the years 1945, 1946, and 1947 was due to fraud with intent to evade tax.

(j) Petitioner having filed false and fraudulent returns with intent to evade tax for each of the taxable years 1945, 1946, and 1947 neither the assessment nor collection of the proposed deficiencies is barred by any statute of limitations under the provisions of section 276(a) of the Internal Revenue Code.

10. Further answering the petition, for an alternative defense, respondent alleges that the five-year period of limitation is applicable under section 275(c) of the Internal Revenue Code for assessment and collection of the income tax deficiency

determined by the Commissioner in the amount of \$12,098.71 for 1947 as set forth in his said notice of deficiency. In support of such determination, respondent alleges and relies upon the following facts:

(a) On March 15, 1948 petitioner filed his federal income tax return for 1947 with the Collector of Internal Revenue for the Sixth District of California, reporting gross income of \$9,603.51, whereas in truth and in fact petitioner's gross income for such year totaled not less than \$34,281.20.

(b) Petitioner improperly omitted from gross income for the year 1947 an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return and the period of limitation upon assessment and collection of the income tax deficiency for the taxable year 1947 had not expired at the time the Commissioner of Internal Revenue mailed his notice of deficiency to petitioner on February 20, 1953 asserting an income tax deficiency for such year.

Wherefore, it is prayed:

1. That the petitioner's appeal be denied and the respondent's determination be approved.

2. That The Tax Court redetermine the correct amounts of deficiencies to be equal to the amounts determined by the Commissioner in his notice of deficiency, namely, \$803.89 for 1945, \$12,052.82 for

1946, and \$12,098.71 for 1947 and that such deficiencies are due to fraud with intent to evade tax.

3. That The Tax Court enter its decision that petitioner knowingly, willfully, and fraudulently prepared and filed his income tax returns for each of the taxable years 1945, 1946, and 1947 with intent to deceive respondent and evade tax and that the 50 per cent fraud penalties of \$401.95 for 1945, \$6,026.41 for 1946, and \$6,049.36 for 1947 imposed under the provisions of section 293(b) of the Internal Revenue Code, attach.

4. That The Tax Court find and hold that the assessment and collection of the proposed deficiencies for the taxable years 1945, 1946, and 1947 are not barred by any statute of limitations under the provisions of section 276(a) of the Internal Revenue Code.

5. In the alternative, that The Tax Court enter its decision that for the taxable year 1947 petitioner improperly omitted from gross income an amount properly includible therein which is in excess of 25 per cent of the amount of gross income stated in the return; that for the year 1947 the five-year period of limitation for assessment and collection of the income tax deficiency for such year attaches pursuant to section 275(c) of the Internal Revenue Code; that the Commissioner's notice of deficiency dated February 20, 1953 was timely mailed to petitioner; and that the assessment and collection of

said income tax deficiency for the year 1947 is not barred.

/s/ KENNETH W. GEMMILL, WBS,
Acting Chief Counsel, Bureau of
Internal Revenue.

Of Counsel: John A. Gilmore, Regional Counsel,
Gene W. Reardon, Acting Appellate Counsel,
William B. Springer, Acting Assistant Appellate Counsel, Marvin E. Hagen, Special Attorney, Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed August 18, 1953.

[Title of Tax Court and Docket No. 48542.]

REPLY

Comes now the above named petitioner by his attorney, Walter L. McVey, Jr., in reply to the Answer of Respondent and denies each and every averment, statement and allegation of new matter therein contained.

Wherefore said Petitioner renews the prayer contained in his original pleading.

/s/ WALTER L. McVEY, JR.,
Counsel for Petitioner.

[Endorsed]: T.C.U.S. Filed November 2, 1953.

[Title of Tax Court and Docket No. 48542.]

MOTION TO AMEND PETITION

Now comes the petitioner and asks leave of Court to amend the petition in this proceeding for the purpose of establishing a loss in farming operations in the State of Kansas for the years 1946 and 1947, in the respective amounts of \$1,085.27 and \$4,874.91, and for the purpose of claiming an overpayment in taxes for the years 1945, 1946 and 1947, in the respective amounts of \$361.75, \$5,423.91 and \$5,444.42, or for overpayments in such other amounts as the Court may determine to have been made. The proposed amendment is hereinafter attached.

The basis of this Motion is as follows:

(1) In compiling income tax returns for the years 1946 and 1947 in Los Angeles, California, the petitioner overlooked a loss on certain farming operations conducted by him in Montgomery County, Kansas, in the respective amounts of \$1,085.27 and \$4,874.91. This matter did not come to the attention of counsel of record in this proceeding until after this proceeding had been scheduled for trial before the Court on the Court's Calendar commencing March 21, 1955. Counsel then examined certain bank accounts relating to said farming operations and obtained from a firm of certified public accountants in Independence, Kansas, certain work papers and data relating to the operations of said farm, all of which information has been exhibited to and discussed with representatives of the Re-

spondent and has been made available to the Internal Revenue Agent sent to the offices of counsel for the petitioner for the purpose of examining said data and information. Counsel for respondent was, before the commencement of the trial on this proceeding, fully apprised of the nature of petitioner's data and information pertaining to said losses and will in no way be prejudiced by the granting of said motion.

(2) The petitioner on or about January 14, 1954, paid to the Director of Internal Revenue at Wichita, Kansas, the sums of \$361.75, \$5,423.91, and \$5,444.42, to apply against a jeopardy assessment which had been made against her on December 24, 1952. These payments and the receipt thereof have been stipulated by written stipulation on file in this proceeding. The taxes reported on the individual returns of the petitioner for the years 1945, 1946, and 1947 have been paid. The Director of Internal Revenue at Los Angeles, California, has furnished counsel for respondent an official certification to this effect.

Respectfully submitted,

/s/ ALVA C. BAIRD,

Counsel for Petitioners.

Of Counsel: Thomas A. Baird, Frank W. Mahoney.

Served April 1, 1955.

[Stamped]: Granted April 1, 1955. Morton P. Fisher, Judge.

[Endorsed]: T.C.U.S. Filed April 1, 1955.

[Title of Tax Court and Docket Nos. 48542-3.]

AMENDMENT TO PETITION

Paragraph 5 of the petition is amended by adding subparagraph (d), as follows:

(d) During the calendar years 1946 and 1947 petitioners Gene O. Clark and Faye Clark were operating a farm for the production of grain in Montgomery County, Kansas; that said farm was acquired on or about July, 1946; that the crops planted in that year to mature in the Spring of 1947 were destroyed by flood; that by reason of the fact that petitioners raised no crop in 1946 and by reason of the fact that the crop planted in 1946 was destroyed as aforesaid in 1947, petitioners had no income from said operations for either 1946 or 1947. Petitioners did expend in said farm operations the amounts of \$2,170.53 and \$9,749.82. Said expenses were incurred in the ordinary course of business and are a proper deduction in determining the petitioners' tax liability for the years 1946 and 1947. One-half of the total amounts spent should be allocated to each petitioner.

The prayer of the petitioners is amended to read as follows:

Petitioners pray that the Court determine there is no deficiency in tax for the years 1945, 1946 and 1947, and that there is an overpayment for each of said years in the respective amounts set out in the following schedule:

Year	Gene Clark	Faye Clark
1945.....	\$ 361.75	\$ 370.80
1946.....	5,423.91	5,470.80
1947.....	5,444.42	5,513.79

Respectfully submitted,

/s/ ALVA C. BAIRD.

Of Counsel: Thomas A. Baird, Frank W. Mahoney.

Served April 1, 1955.

[Endorsed]: T.C.U.S. Filed April 1, 1955.

[Title of Tax Court and Docket No. 48542.]

ANSWER TO AMENDMENT TO PETITION

The Commissioner of Internal Revenue, by his attorney, R. P. Hertzog, Acting Chief Counsel, Internal Revenue Service, for answer to the amendment to petition of the above-named taxpayer, denies as follows:

5. Denies all the allegations contained in subparagraph (d) of paragraph 5 of the amendment to petition.

Wherefore it is prayed that the determination of the Commissioner be approved.

/s/ R. P. HERTZOG, REM,

Acting Chief Counsel, Internal
Revenue Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
E. C. Crouter, Assistant Regional Counsel,
R. E. Maiden, Jr., Special Assistant to the Regional Counsel, Sidney J. Machtinger, Attorney, Internal Revenue Service.

Served April 29, 1955.

[Endorsed]: T.C.U.S. Filed April 28, 1955.

[Title of Tax Court and Docket No. 48543.]

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols A:R:90D:LHP) dated February 20, 1953, and as a basis for his proceeding alleges as follows:

1. The petitioner is an individual with residence at Clark's Buffalo Ranch, Independence, Kansas. During the years 1945, 1946 and 1947, petitioner was a resident of the State of California and the returns for the periods here involved were filed with the Collector of Internal Revenue at Los Angeles, California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to petitioner on February 20, 1953.

3. The deficiency as determined by the Commissioner is in income taxes for the calendar years 1945, 1946 and 1947 in the amount of \$25,234.09, with a penalty of \$12,617.06, making a total of \$37,851.15, all of which amount is in controversy.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner has erroneously assessed tax deficiencies for the years 1945, 1946 and 1947 more than three years after the returns were filed, contrary to the provisions of section 276 (a) of the Internal Revenue Code.

(b) The Commissioner has erroneously assessed tax deficiencies for the years 1945 and 1946 more than five years after the returns were filed, contrary to the provisions of section 276 (c) of the Internal Revenue Code.

(c) The Commissioner has erroneously added to the deficiency a penalty in the amount of \$12,617.06.

(d) No grounds or reasons are stated by the Commissioner for assessing the tax deficiencies beyond the period of limitation or for asserting the penalty in the amount of \$12,617.06. The petitioner contends that there was no intent to evade payment of income taxes for the years 1945, 1946 and 1947. During these years, petitioner was married to Gene O. Clark; however, she took no part nor did she have any knowledge of his business operations. Any income which petitioner may have received during this period was solely by reason of the Community Property Law of the State of California.

(e) In determining the taxable net income of the petitioner for the year 1946, the Commissioner has erroneously determined that petitioner's husband received taxable dividends from Gene Clark, Inc., in the amount of \$44,227.13, petitioner's one-half under California Community Property Law being \$22,113.57, which it is alleged she failed to report in her income tax return for the calendar year 1946.

(f) In determining the taxable net income of the petitioner for the year 1947, the Commissioner has erroneously determined that petitioner's husband received taxable dividends from Gene Clark, Inc., in the amount of \$49,500.99, petitioner's one-half

under California Community Property Law being \$24,750.49, which it is alleged she failed to report in her income tax return for the calendar year 1947.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) That to the best of petitioner's knowledge, the corporation of Gene Clark, Inc., paid out of its earned surplus only one legally declared dividend to petitioner's husband, Gene O. Clark. This dividend was in the amount of \$19,996.17, paid on or about April 30, 1948, and was reported as taxable income by petitioner and her husband in their joint tax return for that calendar year.

6. The petitioner is without adequate knowledge or facts, at this time, to defend herself against the contentions of the Commissioner for the deficiency assessed for the years 1946 and 1947 for the following reasons:

(a) While petitioner shared in the property of her husband, Gene O. Clark, under the Community Property Law of the State of California during the periods here involved, she never took an active part in the business or financial affairs of her husband, and therefore has no records or books of account from which she can contest the contentions of the Commissioner.

(b) Petitioner has been unable to have access to or to examine the corporate records of Gene Clark, Inc., in their entirety since she received notice of deficiency. After receiving notice of defi-

ciency, petitioner's attorney made a trip to California for the purpose of obtaining or examining the complete records of Gene Clark, Inc., in connection with this case; however, petitioner's attorney was denied this right.

(c) The notice of deficiency is insufficient to inform petitioner wherein Commissioner's contentions lie in respect to unreported dividends allegedly received by petitioner's husband, one-half of which dividends were allegedly received by petitioner as her share of the community property.

Wherefore, petitioner prays that this Court may hear the proceeding and redetermine the tax of petitioner for the years 1945, 1946 and 1947 and any deficiency which may be due from petitioner for those years.

/s/ FAYE CLARK,
Petitioner.

Duly Verified.

EXHIBIT "A"

Form 1234

U. S. Treasury Department
Office of the Director of Internal Revenue, Head,
Audit Division, 417 South Hill Street, Los
Angeles 13, California. Feb. 20, 1953

In replying refer to: A:R:90D:LHP.

Mrs. Faye Clark
c/o Clark's Buffalo Ranch, Independence, Kansas.

Dear Mrs. Clark:

You are advised that the determination of your

Exhibit "A"—(Continued)

income tax liability for the taxable years ended December 31, 1945, 1946 and 1947, discloses a deficiency of \$25,234.09 and \$12,617.06 in penalty, as shown in the statement attached. Assessment of such deficiency or deficiencies has been made under the provisions of the internal revenue laws applicable to jeopardy assessments.

In accordance with the provisions of existing internal revenue laws notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays and legal holidays are to be counted in computing the 90-day period.

Very truly yours,

T. COLEMAN ANDREWS,
Commissioner,

/s/ By R. A. RIDDELL,
Director.

Enclosures:

Form 1276
Statement

Exhibit "A"—(Continued)

Statement

A:R:90D:LHP

Mrs. Faye Clark
c/o Clark's Buffalo Ranch
Independence, Kansas

Tax Liability for the Taxable Years Ended December 31, 1945, December 31, 1946 and December 31, 1947.

Summary of Deficiencies

Year	Deficiency	50% Penalty
1945 Income tax	\$ 823.89	\$ 411.95
1946 Income tax	12,157.33	6,078.67
1947 Income tax	12,252.87	6,126.44
Totals	\$25,234.09	\$12,617.06

Summary of assessments made under the provisions of Internal Revenue laws applicable to jeopardy assessments, on December 24, 1952, for the taxable years ended December 31, 1945, December 31, 1946 and December 31, 1947.

Year	Deficiency	50% Penalty	Interest to 12/24/52
1945 Income tax	\$ 823.99	\$ 411.95	\$ 334.89
1946 Income tax	12,157.33	6,078.67	4,212.26
1947 Income tax	12,252.87	6,126.44	3,510.19
Totals	\$25,234.09	\$12,617.06	\$8,057.34

This determination of your income tax and penalty liability has been made upon the basis of information on file in this office.

The 50 per cent penalty shown herein has been asserted in accordance with the provisions of section 293(b) of the Internal Revenue Code.

Adjustments to Net Income

Taxable Year Ended December 31, 1945

Net income as disclosed by return	\$5,504.71
Additional income and unallowable deduction:	
(a) Net profit from business increased \$2,500.00	
(b) Net loss from sale of property	
other than capital assets disallowed	177.87
	2,677.87
Net income adjusted	\$8,182.58

Exhibit "A"—(Continued)

Explanation of Adjustments

(a) It has been determined that your husband realized a net profit of \$17,365.16 from operation of his business, in lieu of \$12,365.16, the amount reported in your return, an increase of \$5,000.00, your community half of which is \$2,500.00.

(b) The deduction of \$355.75 claimed from the sale of property other than capital assets is disallowed. It has been determined that the property sold was your personal automobile, the loss from the sale of which is not an allowable deduction. Your community half of the amount disallowed is \$177.87.

Computation of Tax

Taxable Year Ended December 31, 1945

Net income adjusted	\$8,182.58	
Less: Surtax exemptions	1,000.00	
	<hr/>	
Surtax net income	\$7,182.58	
Surtax		\$1,714.77
Net income adjusted	\$8,182.58	
Less: Normal-tax exemption	500.00	
	<hr/>	
Net income subject to normal tax	\$7,682.58	
Normal tax at 3%		\$ 230.48
		<hr/>
Correct income tax liability		\$1,945.25
Income tax liability shown on return, account No. 3056461		\$1,121.36
		<hr/>
Deficiency of income tax		\$ 823.89
50% Penalty		\$ 411.95

Adjustment to Net Income

Taxable Year Ended December 31, 1946

Net income as disclosed by return	\$14,651.66
Additional income:	
(a) Dividends unreported	22,113.57
	<hr/>
Net income adjusted	\$36,765.23

Explanation of Adjustments

(a) It has been determined that your husband received taxable dividends from Gene Clark, Inc., in the amount of \$44,-

Exhibit "A"—(Continued)

227.13, your one-half \$22,113.57, which you failed to report in your income tax return for the calendar year 1946.

Computation of Tax

Taxable Year Ended December 31, 1946

Net income adjusted	\$36,765.23
Less: Exemptions	1,000.00
<hr/>	
Balance, subject to surtax and normal tax	\$35,765.23
Tentative tax	\$16,907.40
Less 5%	845.37
<hr/>	
Correct income tax liability	\$16,062.03
Income tax liability shown on return, account No. 3039847	3,904.70
<hr/>	
Deficiency of income tax	\$12,157.33
50% Penalty	6,078.67

Adjustments to Net Income

Taxable Year Ended December 31, 1947

Net income as disclosed by return	\$ 9,130.51
Additional income:	
(a) Dividends unreported	24,750.49
<hr/>	
Total	\$33,881.00
Reduction of income:	
(b) Long-term capital gain decreased	99.80
<hr/>	
Net income adjusted	\$33,781.20

Explanation of Adjustments

(a) It has been determined that your husband received taxable dividends from Gene Clark, Inc., in the amount of \$49,500.99, your one-half \$24,750.49, which you failed to report in your income tax return for the calendar year 1947.

(b) It has been determined that a long-term capital gain of \$105.15 was realized by you from the sale of a residence acquired in November, 1946, in lieu of \$304.75, the amount reported in your return, a decrease of \$199.60, your community half of which is \$99.80.

Exhibit "A"—(Continued)

Computation of Alternative Tax
Taxable Year Ended December 31, 1947

Net income adjusted	\$33,781.20
Less: Excess of net long-term capital gain over net short-term capital loss	530.71
Ordinary net income	\$33,250.49
Less: Exemptions	1,000.00
Balance, subject to surtax and normal tax	\$32,250.49
Tentative Tax	\$14,622.82
Less 5%	731.14
Partial tax	\$13,891.68
Plus: 50 per cent of \$530.71	265.35
Alternative tax	\$14,157.03

Computation of Tax
Taxable Year Ended December 31, 1947

Net income adjusted	\$33,781.20
Less: Exemptions	1,000.00
Balance, subject to surtax and normal tax	\$32,781.20
Tentative tax	\$14,967.78
Less 5%	748.39
Total normal tax and surtax	\$14,219.39
Alternative tax	\$14,157.03
Correct income tax liability	\$14,157.03
Income tax liability shown on return, account No. 3050797	1,904.16
Deficiency of income tax	\$12,252.87
50% Penalty	\$ 6,126.44

Served May 20, 1953.

[Endorsed]: T.C.U.S. Filed May 18, 1953.

[Title of Tax Court and Docket No. 48543.]

ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, Kenneth W. Gemmill, Acting Chief Counsel, Bureau of Internal Revenue, and for answer to the petitioner filed in the above-entitled proceeding, admits, denies, alleges, and avers as follows:

1. Admits the allegations of paragraph 1.

2. Admits the allegations of paragraph 2.

3. Admits the deficiencies as determined by the Commissioner are in income taxes and penalties for the calendar years 1945, 1946, and 1947. Denies the remaining allegations of paragraph 3. Avers the deficiencies in income tax and penalties as shown in the notice of deficiency are as follows:

Year	Deficiency	50% Penalty
1945 Income tax	\$ 823.89	\$ 411.95
1946 Income tax	12,157.33	6,078.67
1947 Income tax	12,252.87	6,126.44
	<hr/>	<hr/>
	\$25,234.09	\$12,617.06

4. (a) to (f), inclusive. Denies the allegations of error of paragraph 4 (a) to (f), inclusive.

5. (a) Denies the allegations of paragraph 5 (a).

6. (a) Denies the allegations of paragraph 6 (a) except it is admitted that petitioner shared in the property of her husband, Gene O. Clark under the Community Property Law of the State of California during the periods here involved.

(b) Denies the allegations of paragraph 6 (b).

(c) Denies the allegations of paragraph 6 (c).

7. Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

8. Further answering the petition, respondent affirmatively alleges that petitioner is liable for the 50 per cent fraud penalties imposed under the provisions of section 293 (b) of the Internal Revenue Code for the taxable years 1945, 1946, and 1947 in the respective amounts of \$411.95, \$6,078.67, and \$6,126.44 as determined by the Commissioner and set forth in the notice of deficiency, a copy of which is attached to the petition. In support of the Commissioner's determination of the fraud penalties as set forth in the said notice of deficiency, respondent alleges as follows:

(a) During the taxable years 1945, 1946, and 1947 petitioner was married to Gene O. Clark and they lived together as husband and wife and were residents of the State of California.

(b) The petitioner caused to be prepared and filed with the Collector of Internal Revenue for the Sixth District of California her Federal income tax return for the taxable years 1945, 1946 and 1947 and represented that each of such returns was a true, correct, and complete return.

(c) In truth and in fact each of said income tax returns filed by petitioner for the taxable years

1945, 1946, and 1947 was false and fraudulent. The petitioner's net taxable income and the resulting income tax due thereon were understated in each such return as follows:

Year	Net Income Reported by Petitioner	Tax Liability Reported by Petitioner	Petitioner's Actual Net Income	Petitioner's Correct Tax Liability
1945	\$ 5,504.71	\$1,121.36	\$ 8,182.58	\$ 1,945.25
1946	14,651.66	3,904.70	36,765.23	16,062.03
1947	9,130.51	1,904.16	33,781.20	14,157.03

(d) At the time the aforesaid income tax returns for the taxable years 1945, 1946, and 1947 were prepared and filed the petitioner knew that such returns were false and fraudulent and that the amount of the taxable net income reported therein and the resultant tax liability shown thereon were understated in each of the said returns. The petitioner knowingly, willfully, and fraudulently made and filed her federal income tax returns for the taxable years 1945, 1946, and 1947 with intent to deceive respondent and evade tax.

(e) During the taxable years 1945, 1946, and 1947 petitioner derived and received taxable income from a plumbing contracting business and/or dividend income from Gene Clark, Inc., which she failed to report for federal income tax purposes.

(f) On her income tax return for 1945 petitioner reported net income of \$5,504.71 whereas her correct net income for 1945 was \$8,182.58. The understatement of net income for 1945 consisted of unreported net income from a plumbing contracting business and the overstatement of a claimed

deduction for a net loss from the sale or exchange of a Packard automobile.

(g) On her income tax return for 1946 petitioner reported net income of \$14,651.66 whereas her correct net income for 1946 was \$36,765.23. The understatement of net income for 1946 consisted of unreported taxable dividend distributions received by petitioner from Gene Clark, Inc.

(h) On her income tax return for 1947 petitioner reported net income of \$9,130.51 whereas her correct net income for 1947 was \$33,781.20. The understatement of net income for 1947 consisted of unreported taxable dividend distributions received by petitioner from Gene Clark, Inc. In determining the deficiency the Commissioner reduced petitioner's taxable income by the sum of \$99.80 representing her community share of the overstatement of a long-term capital gain realized from the sale of a residence.

(i) The understatement of net income and income tax liability for each of the years 1945, 1946, and 1947 was due to fraud with intent to evade tax.

(j) Petitioner having filed false and fraudulent returns with intent to evade tax for each of the taxable years 1945, 1946, and 1947 neither the assessment nor collection of the proposed deficiencies is barred by any statute of limitations under the provisions of section 276(a) of the Internal Revenue Code.

9. Further answering the petition, for an alter-

native defense, respondent alleges that the five-year period of limitation is applicable under section 275 (c) of the Internal Revenue Code for assessment and collection of the income tax deficiency determined by the Commissioner in the amount of \$12,252.87 for 1947 as set forth in his said notice of deficiency. In support of such determination, respondent alleges and relies upon the following facts:

(a) On March 15, 1948 petitioner filed her federal income tax return for 1947 with the Collector of Internal Revenue for the Sixth District of California, reporting gross income of \$9,630.51 whereas in truth and in fact petitioner's gross income for such year totaled not less than \$34,281.20.

(b) Petitioner improperly omitted from gross income for the year 1947 an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return and the period of limitation upon assessment and collection of the income tax deficiency for the taxable year 1947 had not expired at the time the Commissioner of Internal Revenue mailed his notice of deficiency to petitioner on February 20, 1953 asserting an income tax deficiency for such year.

Wherefore, it is prayed:

1. That the petitioner's appeal be denied and the respondent's determination be approved.
2. That the Tax Court redetermine the correct

amounts of deficiencies to be equal to the amounts determined by the Commissioner in his notice of deficiency, namely, \$823.89 for 1945, \$12,157.33 for 1946 and \$12,252.87 for 1947 and that such deficiencies are due to fraud with intent to evade tax.

3. That the Tax Court enter its decision that petitioner knowingly, willfully, and fraudulently prepared and filed her income tax returns for each of the taxable years 1945, 1946, and 1947 with intent to deceive respondent and evade tax and that the 50 per cent fraud penalties of \$411.95 for 1945, \$6,078.67 for 1946, and \$6,126.44 for 1947 imposed under the provisions of section 293(b) of the Internal Revenue Code, attach.

4. That the Tax Court find and hold that the assessment and collection of the proposed deficiencies for the taxable years 1945, 1946, and 1947 are not barred by any statute of limitations under the provisions of section 276(a) of the Internal Revenue Code.

5. In the alternative, that the Tax Court enter its decision that for the taxable year 1947 petitioner improperly omitted from gross income an amount properly includible therein which is in excess of 25 per cent of the amount of gross income stated in the return; that for the year 1947 the five-year period of limitation for assessment and collection of the income tax deficiency for such year attaches pursuant to section 275(c) of the Internal Revenue Code; that the Commissioner's notice of deficiency dated February 20, 1953 was timely

mailed to petitioner; and that the assessment and collection of said income tax deficiency for the year 1947 is not barred.

/s/ KENNETH W. GEMMILL, WBS
Acting Chief Counsel,
Bureau of Internal Revenue.

Of Counsel: John A. Gilmore, Regional Counsel,
Gene W. Reardon, Acting Appellate Counsel,
William B. Springer, Acting Assistant Appellate Counsel, Marvin E. Hagen, Special Attorney, Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed August 18, 1953.

[Title of Tax Court and Docket No. 48543.]

REPLY

Comes now the above named Petitioner by her attorney, Walter L. McVey, Jr., in reply to the Answer of Respondent and denies each and every averment, statement and allegation of new matter therein contained.

Wherefore said Petitioner renews the prayer contained in her original pleading.

/s/ WALTER L. McVEY, JR.,
Counsel for Petitioner.

[Endorsed]: T.C.U.S. Filed November 2, 1953.

[Title of Tax Court and Docket No. 48543.]

MOTION TO AMEND PETITION

Now comes the petitioner and asks leave of the Court to amend the petition in this proceeding for the purpose of establishing a loss in farming operations in the State of Kansas for the years 1946 and 1947, in the respective amounts of \$1,085.26 and \$4,874.91, and for the purpose of claiming an overpayment in taxes for the years 1945, 1946 and 1947, in the respective amounts of \$370.80, \$5,470.80 and \$5,513.79, or for overpayments in such other amounts as the Court may determine to have been made. The proposed amendment is hereinafter attached.

The basis of this Motion is as follows:

(1) In compiling income tax returns for the years 1946 and 1947 in Los Angeles, California, the petitioner overlooked a loss on certain farming operations conducted by her in Montgomery County, Kansas, in the respective amounts of \$1,085.26 and \$4,874.91. This matter did not come to the attention of counsel of record in this proceeding until after this proceeding had been scheduled for trial before the Court on the Court's Calendar commencing March 21, 1955. Counsel then examined certain bank accounts relating to said farming operations and obtained from a firm of certified public accountants in Independence, Kansas, certain work papers and data relating to the operations of said farm, all of which information has been exhibited to and discussed with representatives of the

Respondent and has been made available to the Internal Revenue Agent sent to the offices of counsel for the petitioner for the purpose of examining said data and information. Counsel for respondent was, before the commencement of the trial on this proceeding, fully apprised of the nature of petitioner's data and information pertaining to said losses and will in no way be prejudiced by the granting of said motion.

(2) The petitioner on or about January 14, 1954, paid to the Director of Internal Revenue at Wichita, Kansas, the sums of \$370.80, \$5,470.80, and \$5,513.79 to apply against a jeopardy assessment which had been made against her on December 24, 1952. These payments and the receipt thereof have been stipulated by written stipulation on file in this proceeding. The taxes reported on the individual returns of the petitioner for the years 1945, 1946 and 1947 have been paid. The Director of Internal Revenue at Los Angeles, California, has furnished counsel for respondent an official certification to this effect.

Respectfully submitted,

/s/ ALVA C. BAIRD,

Counsel for Petitioners.

Of Counsel: Thomas A. Baird, Frank W. Mahoney.

[Stamped]: Granted April 1, 1955. Morton P. Fisher, Judge.

Served April 1, 1955.

[Endorsed]: T.C.U.S. Filed April 1, 1955.

[Title of Tax Court and Docket No. 48543.]

ANSWER TO AMENDMENT TO PETITION

The Commissioner of Internal Revenue, by his attorney R. P. Hertzog, Acting Chief Counsel, Internal Revenue Service, for answer to the amendment to petition of the above-named taxpayer, denies as follows:

5. Denies all the allegations contained in subparagraph (d) of paragraph 5 of the amendment to petition.

Wherefore it is prayed that the determination of the Commissioner be approved.

/s/ R. P. HERTZOG, REM,
Acting Chief Counsel, Internal
Revenue Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
E. C. Crouter, Assistant Regional Counsel,
R. E. Maiden, Jr., Special Assistant to the
Regional Counsel, Sidney J. Machtinger, At-
torney, Internal Revenue Service.

Served April 29, 1955.

[Endorsed]: T.C.U.S. Filed April 28, 1955.

The Tax Court of the United States

Docket Nos. 48542-3-4

MINUTES OF PROCEEDINGS

Date: March 28, 30, 31, April 1, 1955. Place: Los Angeles, Calif.

Proceeding: Gene O. Clark et al.

Assigned to Judge Morton P. Fisher. Division No. 15.

Counsel For Petitioner: Alva A. Baird, Esq., Thomas A. Baird, Esq., 458 South Spring St., Los Angeles 13, California. For Respondent: Sidney Machtinger, Esq., Earl J. Gardner, Esq.

Stenographic Reporters: Frances Way, Herbert Aaisness.

Hearing: March 28, 30, 31, SUB. Transcript Ordered: Yes.

On the merits: Yes. On oral motion of petitioners for consolidation. No objection. Oral motion of resp. to amend pleadings to conform to proof. Written motions to amend petitions by petitioner.

Ordered: Consolidation Granted. Oral mot. of resp. to amend pleadings. CAV. Written motions to amend petitions by pet. Granted. Respondent given 30 days to file reply or to move thereto. (30 days would fall on May 2, 1955.)

Filed at hearing: Stip. of Facts: Memorandum re Plea of Nolo Contendere. 48542, Motion to Amend Petition (served 4/1/55). 48543, Motion to Amend Petition (served 4/1/55). 48542, 48543,

Amendment to Petition (served 4/1/55). 48544, Motion to Amend (served 4/1/55).

Simultaneous briefs: 90 days, June 30, 1955.
30 days, August 1, 1955.

Witnesses for Petitioner: Parris P. Claypool, Gene Clark.

Witnesses for Respondent: Y. L. Creed, Truman Johnson, Ben Lang, Frances E. Bittinger, Lloyd George Meissenburg, Jack P. Hudson, Frederick W. Files, Donald P. Phillips, Kenneth S. Stutzman.

Petitioner's Exhibits:

- 1-A—RAR Gene O. Clark;
- 2-B—RAR Gene O. and Faye Clark;
- 3-C—RAR Gene Clark, Inc.;
- 4-D—1945 Return Gene O. Clark;
- 5-E—1946 Return Gene O. Clark;
- 6-F—1947 Return Gene O. Clark;
- 7-G—1945 Return Faye Clark;
- 8-H—1946 Return Faye Clark;
- 9-I—1947 Return Faye Clark;
- 10-J—1948 Return Gene O. Clark and Faye Clark—also amended return;
- 11-K—1949 Return Gene O. and Faye Clark;
- 12-L—1947 Return Gene Clark, Inc.;
- 13-M—1948 Return Gene Clark, Inc.;
- 14-N—1949 Return Gene Clark, Inc.;
- 15—Gene Clark, Inc. Fiscal 1947 Analysis of Income Available for Distribution to Stockholders Bases on Report of RA, D. E. Phillips;
- 16—Fiscal 1947 Gene O. Clark, Inc. Comparative Analysis of Surplus Based Upon Report of Exam-

ination by RA Don E. Phillips and 90 day Letter Showing Amount Available for Distribution as a Constructive Dividend;

17—Gene Clark, Inc. Balance Sheets;

18—Gene Clark, Inc. Disposition of Income Reported in Return Fiscal Year April 30, 1947;

19—General Ledger (4 sheets) Record of Journal Entries (3 sheets);

See Koyl case for exhibits:

20-WW—RAR Gene Clark, Inc.;

21-XX—Cash Receipts Unidentified FYE 1950 Gene Clark, Inc.;

22-YY—Cash Receipts Unidentified FYE 1949 Gene Clark, Inc.;

23-ZZ—Cash Receipts Unidentified FYE 1948 Gene Clark, Inc.;

24-AAA—Cash Receipts Not Located in Deposits FYE 1947 Gene Clark, Inc.;

25—Map;

26—Minutes (10 sheets);

27—Agreement dated Jan. 28, 1949;

28—Affirmation of sale;

29—Assumption of Obligation 3/29/48;

30—Note 98077 2/5/48;

31—Note 98076 2/5/48;

32—Check 4602 \$450.00;

33—Check 4605 \$102.15;

34—Check 4606 \$274.95;

35—Check 4607 \$50.00;

36—Check 4608 \$50.00;

37—Check 4609 \$50.00;

- 38—Check 4610 \$20.00;
 - 39—Check 4612 \$50.00;
 - 40—Check 4613 \$50.00;
 - 41—Check 4614 \$195.57;
 - 42—Check 4615 \$50.00;
 - 43—Check 4616 \$50.00;
 - 44—Check 4617 \$50.00;
 - 45—Check 4618 \$36.50;
 - 46—Check 4619 \$590.36;
 - 47—Check 4620 \$50.00;
 - 48—Check 4603 \$50.00;
 - 49—MFI (offered but not admitted) Income Tax Schedule;
 - 50—Check 4621 \$50.00;
 - 51—Check 4622 \$85.00;
 - 52—Check 4623 \$50.00;
 - 53—Check 4624 \$50.00;
 - 54—Check 4627 \$50.00;
 - 55—MFI only;
 - 56—Receipt Montgomery Taxes;
 - 57—Cert. of Payments and Assessment (3 sheets).
- Respondent's Exhibits:
- O—Affidavit of Y. L. Creed;
 - P—Check No. 11 Y. L. Creed;
 - Q—Plumbing Contract;
 - R—Plumbing Contract;
 - S—Check 3008 Ben Lang;
 - T—Invoice (2) Ben Lang;
 - U—Check No. 1534 Hamilton Homes, Statement dated 8/14/47, Invoice 8/14/47;

V—Check No. 1476 Hamilton Homes, Statement 7/9/47;

W—Check No. 1539 Hamilton Homes, Invoice dated 2/11/47, Invoice dated 8/26/47, Heaters on Tract Invoice 9/9/46, Invoice 8/29/46;

X—Check No. 52, 68, Invoice Sept. 10, 1947;

Y—Check No. 3787;

Z—(This letter not used);

AA—Checks 2936, 212, 3351, 3696, 4587, 659, 581, Valley City Supply Co. Invoice 3351, 3696, 4587, 442, 212, Statement Invoice 1/16/47, Invoice 1/18/47, Valley City Supply Invoice—Delivered to Valley Cities;

BB—Check No. 537807, Check No. 537806, Check No. 392991, 394131, 395227, 392653;

CC—Check No. 2313 Mitchell & Son;

DD—Check No. 866, Invoice Jan. 21, 1948;

EE—Check No. 2346;

FF—Receipt No. 5493, 5492, 5494, 5491;

GG—Southern California Investment Co.;

HH—Loss on Sale of Property other than Capital;

A—Assets May 1, 1947-April 30, 1948;

II—Receipt Sept. 16, 1947;

JJ—Hamilton Homes (4 sheets);

KK—Journal Entries Folio 18;

LL—Check No. 16510 Valley Blvd. Plumbing & Electric Co.;

MM—Check No. 16561 Valley Blvd. Plumbing & Electric Co.;

NN—Recap of Material Purchased and Payment Made From Merssenberg's record;

OO—Photostat Receipt 3/2/48;

PP—MFI (offered but not admitted) FyE 4/30/47 Gene Clark Inc. Adjustment to Net Income and Distribution to Shareholders;

QQ—MFI only (offered but not admitted) Stipulation of deficiency Gene Clark, Inc.;

RR—Story & Sons 1948;

SS—Gene Clark, Inc. Sale of Business Assets 5/1/47 to 4/30/48;

TT—Check No. 1774 A&F Plumbing & Heating Co., 3 invoices (Receipted);

UU—Check No. 1167, 1188, 1160, 1273, Victor Kinsel;

VV—J. M. Young Dr. Cr. Acc. Rec. Adv.;

BBB—Bank Statement George Meissenbuerg, Statement;

CCC—Judgment & Commitment.

/s/ PATRICK CASEY,
Deputy Clerk.

T. C. Memo. 1957-129

Tax Court of the United States

Gene O. Clark, Petitioner, v. Commissioner of Internal Revenue, Respondent.

Faye Clark, Petitioner, v. Commissioner of Internal Revenue, Respondent.

Gene O. Clark and Faye Clark, Husband and Wife, Petitioners, v. Commissioner of Internal Revenue, Respondent.

Docket Nos. 48542, 48543, 48544.¹

Filed July 17, 1957.

MEMORANDUM FINDINGS OF FACT AND OPINION

Petitioner Gene O. Clark, president and majority stockholder of Gene Clark, Inc., from April 23, 1946, through March 1, 1949, inclusive, was the dominating factor in conducting and controlling its corporate affairs. The corporation received substantial amounts of taxable income from unrecorded sales which it failed to report on its returns. Peti-

¹ The instant case presents some issues similar to those involved in *Archie M. Koyl, et al., v. Commissioner*, Docket Nos. 48336, 48337, 48338, in which case Findings of Fact and Opinion are filed simultaneously herewith. The proceedings in the two cases have not been consolidated. It has been stipulated, however, that there shall be incorporated as evidence into the record in the instant case, so far as relevant, all of the testimony material herein given by revenue agent Donald E. Phillips, and exhibits relating thereto, in the Koyl case, *supra*. There is, however, specifically excluded from consideration in the instant proceeding the stipulations in the Koyl

tioner withheld and diverted to his own purposes substantial amounts out of the proceeds of such unreported sales.

Held:

1. Petitioners realized unreported income from informal or constructive dividends from Gene Clark, Inc., for the calendar years 1946 and 1947, reportable for income tax purposes on the community property basis. Farm losses determined for 1946 and 1947. Long-term capital gain for 1947 adjusted. Unreported income determined for 1946 and 1947.

2. Petitioners did not understate taxable income in their joint returns for 1948 and 1949.

3. Petitioner Faye Clark's individual income tax returns for 1946 and 1947 were not false and fraudulent with intent to evade taxes. Assessment and collection as to Faye Clark barred by limitations as to the year 1946 but not as to the year 1947, because of omission from gross income in her return for that year of amounts properly includible therein which are in excess of 25 per centum of the amount of gross income stated in said return.

4. Each of the returns of Gene O. Clark for the

case relating to net income as adjusted, deficiencies and additions to tax for fraud of Gene Clark, Inc., for the fiscal years 1947 through 1950, inclusive, since the petitioners herein were not parties to said stipulations and petitioners' objection to their use has been sustained. What otherwise would appear to be inconsistent results stem from the material differences in the records of the respective cases as presented to us, including differing stipulations of fact.

years 1946 and 1947 was false and fraudulent with intent to evade taxes.

5. A part of the deficiency of Gene O. Clark for each of the years 1946 and 1947 was due to fraud with intent to evade taxes. Additions to tax under section 293(b) of the Internal Revenue Code of 1949 are applied for said years.

Thomas A. Baird, Esq., and Alva C. Baird, Esq., for the petitioners.

Sidney Machtinger, Esq., and Earl J. Gardner, Esq., for the respondent.

Fisher, Judge: This consolidated proceeding involves deficiencies in income tax and additions to tax determined against petitioners as follows:

Petitioner	Year	Deficiency	Sec. 293(b) Additions to Tax
Gene O. Clark	1945	\$ 803.89	\$ 401.95
Gene O. Clark	1946	12,052.82	6,026.41
Gene O. Clark	1947	12,098.71	6,049.36
Faye Clark	1945	823.89	411.95
Faye Clark	1946	12,157.33	6,078.67
Faye Clark	1947	12,252.87	6,126.44
Gene O. Clark and Faye Clark	1948	19,780.57	9,890.29
Gene O. Clark and Faye Clark	1949	7,472.72	3,736.36

Claim to additions to tax with respect to petitioner Faye Clark for the calendar years 1946 and 1947 has been waived by respondent. The parties have stipulated that the year 1945 is not presently in issue and that there will be an overpayment of tax in such year, the amount thereof to be reflected in the Rule 50 computation. The parties also stipu-

lated that petitioners sustained a net operating loss during 1950 in the amount of \$4,513.62, and that said amount is properly allowable as a loss carry-back to the year 1949. Other stipulated adjustments between the parties will likewise be reflected in the Rule 50 computation.

The principal issues presented for our consideration are: (1) whether petitioners received constructive dividends for any of the years 1946 through 1949, inclusive, from Gene Clark, Inc., which they failed to report on their individual tax returns for 1946 and 1947 and their joint returns for 1948 and 1949, and, if so, in what amounts; (2) whether petitioners realized unreported capital gains for either or both of the years 1948 and 1949; (3) whether any part of the several deficiencies determined for each of the taxable years in issue was due to fraud with intent to evade tax; (4) whether assessment and collection of any of the deficiencies determined against Gene or Faye Clark for 1946 and 1947 are barred by the statute of limitations, and (5) whether petitioners sustained unallowed farm losses for the taxable years 1946 and 1947.

General Findings of Fact

The facts are partly stipulated and to the extent so stipulated are incorporated herein by reference.

Petitioners, Gene O. and Faye Clark, are husband and wife, and during the calendar years 1946, 1947 and 1948 resided in Los Angeles County, California. In March 1949, they moved to Independence, Kansas, and for the remainder of the year were resi-

dents of Kansas. All income derived by petitioners during the years 1946 to 1948, inclusive, was community income. For the calendar years 1946 and 1947, they filed separate income tax returns on the community property basis and for the calendar year 1948, they filed a joint return with the collector of internal revenue of Los Angeles, California. For the year 1949, they filed a joint income tax return with the collector of internal revenue for the district of Wichita, Kansas.

Prior to April 23, 1946, Gene O. Clark (hereinafter sometimes called petitioner) and Archie Koyl were associated in a business venture known as Gene Clark Plumbing Co. (hereinafter sometimes referred to as the Plumbing Co.), consisting of two shops, located in El Monte and Bell Gardens, California, and having a labor force of approximately 35 employees. The Plumbing Co. was engaged primarily in selling plumbing supplies and rendering plumbing services to building contractors. No certificate for doing business under a fictitious name was filed on behalf of Plumbing Co. to show that it was a partnership.

Petitioner and Archie Koyl organized a California corporation, Gene O. Clark, Inc., now known as Atlas Pipe and Supply Company (hereinafter sometimes called the corporation), on April 23, 1946,² to engage in the wholesale plumbing business.

² Although the parties repeatedly refer to the date of incorporation as May 1, 1946, the record shows that the official date of incorporation was April 23, 1946.

Of the 522 shares of \$100 par value stock authorized, 364 shares were issued to petitioner, president of the corporation, and 157 shares to Archie M. Koyl, vice president. One qualifying share was issued to another individual who is not involved herein. Petitioner acquired his shares at a cost of \$36,500. Petitioner's shares represented an ownership interest in said corporation of approximately 70 per cent.

On or about March 29, 1948, petitioner purchased the 157 shares of stock owned by Koyl for \$24,714.49. The sale of Koyl's interest therein was consummated by a document designated "Assumption of Obligation," dated March 29, 1948, filed as petitioners' Exhibit 29 and incorporated herein by reference.

Thereafter, in December 1948, Clark informed Koyl that he desired to sell out his entire interest in Gene Clark, Inc., to Koyl. On or about March 1, 1949, Clark sold all of his stock to the Koyls, 262 shares to Archie and 260 shares to Fawn, a total of 522 shares.

During the fiscal years ended April 30, 1947, to 1950, inclusive, the proportional stock ownership in Gene Clark, Inc., is summarized as follows:

Date	Clark	Koyl
April 23, 1946 to March 31, 1948	70%	30%
March 31, 1948 to March 1, 1949	100%	
March 1, 1949 to April 30, 1950		100% ³

³ Including shares of Fawn Koyl.

Gene Clark, Inc., commenced its business operations on or about April 23, 1946, occupying the same premises as the Plumbing Co. Within a few months after the formation of the corporation, the inventory of the Plumbing Co. and that of the corporation were commingled and were thereafter kept as a single unit. The only employees on the business premises were those of the corporation. No records were kept that could properly reflect business transactions of any plumbing enterprise other than the corporation. The only book kept in the office that had any connection with Plumbing Co. was a check book on the Bank of America in El Monte. No Federal tax returns were filed on behalf of Plumbing Co. for any period after April 23, 1946.

Plumbing Co. existed, however, for an indeterminate period after the organization of the corporation, solely for the purpose of buying and selling plumbing materials in violation of the then existent regulations of the Office of Price Administration (O.P.A.). This was done because Plumbing Co. did not hold any license to do business which could be forfeited if it were found guilty of violating O.P.A. regulations. Plumbing Co. was to serve as a front in such transactions for the corporation which did hold a license to do business.

The corporation kept its books on an accrual method and reported its income on a fiscal year basis beginning with the year ending April 30, 1947.

After incorporation of the plumbing enterprise, customers would frequently make out checks to

Gene Clark, to the corporation or to Plumbing Co. To obviate the resultant confusion, the corporation adopted a rubber stamp showing all three designations in order that it might properly endorse any check. This composite stamp was used throughout the period here in question.

During each of the taxable years in which Clark was an officer and stockholder of Gene Clark, Inc., substantial but undisclosed and undetermined amounts of receipts from sales made by the corporation were neither recorded on its books nor reported on its income tax returns. During the fiscal years involved herein, the net income of Gene Clark, Inc., reported on its returns (the tax liability of which is material here because of its reflection upon the issues involving petitioners) the total additions to its net income as found by the revenue agent, and its total net income as so found are as follows:⁴

Year	Net Income per Returns	Additions to Net Income per Revenue Agent's Report	Total Net Income per Revenue Agent's Report
1947	\$30,632.10	\$102,050.17	\$132,682.27
1948	16,726.40	92,208.62	108,935.02
1949	(4,154.03)	46,575.16	42,421.16

⁴ The additions to net income and the total net income here listed were predicated upon the computations contained in a report prepared by respondent's agent during the investigation of the income tax liability of Gene Clark, Inc., which report (discussed *infra*) was received in evidence by stipulation of the parties for the purpose of explaining the basis of respondent's ultimate determination, but not as evidence of the facts contained therein.

Joint Exhibits 3-C, 1-A, and 2-B, being, respectively, the revenue agent's reports on Gene Clark, Inc., for the fiscal years ending April 30, 1947-1949, inclusive; the petitioners' separate returns for 1945, 1946 and 1947; and petitioners' joint returns for 1948 and 1949, are incorporated herein by reference.

Up to March 1, 1949, (when he sold out his entire interest to the Koyls), petitioner was in general control of the over-all corporate operations and dictated its financial policies. Clark was in full charge of the main office in El Monte. Archie Koyl directed the activities at the shop in Bell Gardens. Virtually all other corporate activities, including the maintenance of corporate records and the disposition of receipts, were under the direct control of petitioner.

Fred Files, comptroller and office manager of the corporation, worked under the immediate supervision and direction of petitioner. Files' duties consisted primarily of handling receipts and keeping proper office records. He worked at both shops, keeping one set of books for the entire operation, though consecutively numbered duplicate receipt books were maintained in both shops. When cash was received from a customer, the amount thereof was recorded in the receipt book which was, in substance, merely a memorandum that was later transferred to the "cash receipts" journal in the books of account. Cash sales were sometimes totalled daily and sometimes only several times a week. A single "cash receipt" figure was usually recorded in the journal for the total amount of the separate sales.

Deposits of the total cash receipts were made in the corporation's bank account and generally recorded weekly in the cash receipts journal. Files, who handled all of the bank deposits of the corporation, regularly deposited all cash receipts of the corporation which were turned over to him for such purpose by Gene Clark. On a number of occasions, however, Gene instructed Files to set aside the cash proceeds from certain sales and to turn such funds over to him without recording the sales on the books. Also, at different times, petitioner would give Files checks made out to the corporation by customers for sales, which sales were unrecorded on the corporate books, in exchange for the cash taken by petitioner. An undetermined part of such cash proceeds were used by the officer-stockholder to cash checks as an accommodation for neighborhood stores and workmen in relatively small sums ranging up to \$100. There was a substantial but undetermined difference in the amount of cash Files recorded in corporate books or deposited in its bank accounts and the amount of cash sales actually made by the corporation. The aforementioned method of handling cash sales was also the general practice of Plumbing Co. and was not altered by the coming into existence of the corporation during the entire taxable period involved herein.

Between May 1946 and December 1946, petitioner, on behalf of the corporation, frequently sold and shipped plumbing materials from the El Monte yard without any entry being made for the transactions in the corporate records. Some of such ship-

ments represented "trading transactions" or non-profit exchanges of materials with competitors for mutual convenience.

Subsequent to December 1946, petitioner frequently sold and traded plumbing equipment on behalf of the corporation. He also sold and traded used vehicles. Files was not supplied with the appropriate sales slips and proceeds on many of these transactions. Sometimes Clark would simply give the comptroller a check, without adequate details connected with the sale, and instruct him to remove the particular asset from the corporate books.

During 1947, when maximum ceiling price regulations on plumbing supplies were in effect under the Office of Price Administration, Clark engaged in black market activities. When he dealt in such illicit activities, petitioner would generally pay an undisclosed amount of cash for the purchase of materials over the price indicated on the invoice. These cash funds were taken from unreported corporate receipts. The over-ceiling cash payment was not recorded on the corporate books as part of the total cost of the illicit purchases. Neither petitioner, Plumbing Co., nor the corporation reported the profits from such illegal sales transactions.

During each of the taxable years in question, petitioner also had an arrangement with Keenan Pipe and Supply Co. whereby he was able to purchase materials on behalf of the corporation at one-third off for cash. Under this arrangement, indeterminate amounts of such purchases were made and paid for (usually with receipts obtained from unre-

ported corporate sales), the parties agreeing not to keep any records of their cash transactions.

Apart from the foregoing *modus operandi* during each of the years involved herein, Gene Clark, Inc., made numerous purchases of plumbing materials in the normal course of business which were not recorded on the corporate books, but the subsequent sales thereof were likewise unrecorded. Also, in many instances, the profits from such sales were neither reported by the corporation on its income tax returns nor by petitioners on their returns for the years in issue. The corporation also rendered plumbing services for building contractors on a number of housing projects during the years in question, and petitioner failed to record the full receipts therefor on its books.

Y. L. Creed Transaction

Between December 1945 and March 1946, Gene Clark performed extensive plumbing work for Y. L. Creed, a general contractor, on four houses being constructed in Maywood, California. Creed agreed to pay a total of \$2,922.50 for such services, of which the first payment was made by a check in the sum of \$544, on February 5, 1946. The same day, the check for \$544 was deposited to the account of Gene Clark Plumbing Co., and recorded in the sales of that company. The remaining \$2,378.50 was credited to petitioner by Creed in June 1946, on account of the purchase price of a house (5957 Otis Avenue, Maywood, California) which petitioner purchased from him for a total consideration of \$8,500. The

balance of the purchase price was represented by a trust deed made out in favor of Creed and a cash payment of \$1,400 placed in escrow by Clark. The credit of \$2,378.50 was not reported on the income tax return of Gene Clark or Gene Clark, Inc. The Plumbing Co. filed no return for this period. See further Findings *infra*, paragraph (3) under heading "Matters Relating to Earnings and Profits available for Distribution."

Unreported Transactions—Gene Clark, Inc.

On October 5, 1946, Gene Clark, Inc., and Truman Johnson, a building contractor, executed a contract under which the corporation was to supply plumbing materials and services to Johnson on 10 new houses in West Covina, California. The contract price set forth in the written contract was \$3,300, but the actual price was \$9,300. (On January 22, 1947, the parties executed another contract for similar services on a housing project, consisting of 40 houses being built in West Covina at a cost of \$930 per house or a total of \$37,200.) About the same time it rendered these plumbing services to Johnson, Gene Clark, Inc., purchased a house from him for a total price of \$22,000. The price per unit of the 10 houses to be serviced under the October 5, 1946, contract was \$930 per house. The difference of \$6,000 between the written contract price of \$3,300 and the actual (though unexpressed) contract price of \$9,300 represented part payment on the house which the corporation purchased from Johnson. The corporation was credited by Johnson with the

difference of \$6,000 on the purchase of the house in 1946. Likewise, Johnson's books reflected the full cost of the materials and services furnished, including the \$6,000 in question. The transaction was handled in the foregoing manner at the request of petitioner. The \$6,000 credit was neither recorded on the books of Gene Clark, Inc., nor reported on the corporate income tax returns for any year involved herein. In September 1947, the corporation sold the house to Clark at an amount which was about \$3,137.90 less than the actual cost. The amount of the selling price to Clark was set up as an account receivable on the books of the corporation.

In the year 1947, the following amounts were received by Gene Clark, Inc., from Hamilton Homes, Inc., for plumbing material and services, which were not included in the sales of Gene Clark, Inc.:

Date	Amount
9/10/47	\$1,221.00
9/16/47	2,295.00
7/ 9/47	2,170.00

A receipt for \$8,241.42 dated September 16, 1947, was issued to Gene Clark with the notation "Payment in full for Equity in House at 1825 Vine," and the amount thereof was credited to Gene on the "Accounts Receivable — Officers" account of Gene Clark, Inc., by entry dated September 30, 1947. On September 16, 1947, (the same day the receipt for \$8,241.42 was issued to petitioner), the corporation made a bank deposit in its commercial bank account at Citizens National Bank of Maywood, California,

in the amount of \$21,180.51, which included, in addition to an undisclosed amount of cash, two of the three checks (in the respective amounts of \$1,221 and \$2,295) representing unrecorded sales received from Hamilton Homes, Inc. The third check for \$2,170 was deposited by the corporation on July 30, 1947, as part of a deposit in the amount of \$10,016.46. The three checks from Hamilton Homes, Inc., were substituted for other receipts from sales recorded on the corporate books but not deposited.

Gene Clark, Inc., received a check dated September 15, 1947, in the amount of \$1,000 from H. K. Niles, which was not reported in the corporate books as a sale, but was included in the corporation's bank deposit of September 16, 1947, mentioned above, in the amount of \$21,180.51. This check was likewise an item substituted for other sales recorded on the books but not deposited.

The following checks were also received by petitioner on behalf of the corporation for materials and plumbing services:

Payable to	Amount	Date	Payor
Gene Clark	\$2,294.50	1/14/48	Allen T. Mitchell & Son
Gene Clark			
Plumbing Co.	1,158.44	2/10/48	A. & F. Plumbing & Heating Co.
Gene Clark (endorsed "Gene Clark")	1,558.44	4/20/48	Ben Lang

It was stipulated that the above amounts were not entered on the books and records of the corporation as sales, nor were they reported for tax pur-

poses on the income tax returns of the corporation or of the petitioners for the years in issue.

It was likewise stipulated that during 1948, petitioner received the following amounts, totalling \$38,009.74, from Lloyd H. Meissenburg, of George A. Meissenburg (Valley Boulevard Plumbing & Electric Co.), plumbing contractors, for plumbing materials, which amounts also were not recorded in the corporate records or reported on the income tax returns of either Gene Clark, Inc., or the petitioners for any of the years involved herein:

Method of Payment	Date	Amount	Payable to	Endorsed by
Check	2/ 9/48	\$22,935.00	Gene Clark	Gene Clark
Check	1/29/48	3,074.74	Gene Clark	Gene Clark
Cash	3/ 2/48	12,000.00		

Of the total of \$38,009.74 received as above noted, Clark retained approximately 70 per cent and gave Koyl approximately 30 per cent.

A check in the amount of \$1,700, received by the corporation (made payable to Gene Clark) in payment for one of its vehicles, was drawn by Walter A. Story on February 12, 1948. There is no evidence in the record that the check was entered on the books of the company.

On March 4, 1948, petitioner received a check in the amount of \$6,670 from the Southern California Investment Company for rough plumbing (on some 23 houses at \$290 per unit) payable to Gene Clark, Inc. The check for \$6,670 was endorsed "Gene Clark, Inc., Gene Clark" and cashed March 19,

1948. A cashier's check in the amount of \$6,670 payable to Gene Clark, Inc., was acquired the same date and was deposited March 31, 1948, in the commercial bank account of Gene Clark, Inc., at Citizens National Bank, Maywood, as part of an overall deposit of \$12,816.85. The receipt of the \$6,670 was not recorded as a sale in the records of Gene Clark, Inc., nor was it reported as income by either the corporation or petitioners. The deposit of the cashier's check of \$6,670 was in substitution for other receipts recorded on the books of Gene Clark, Inc., but not deposited in the corporation's bank account.

On March 20, 1948, the day after the cashier's check was acquired, Gene Clark, Inc., received a total amount of \$6,610 in cash from the following four separate transactions, for each of which the corporation comptroller issued a cash receipt. The corporation received \$1,250 in cash from the sale of a 1947 Chevrolet truck. The transaction was reported in the corporation's return for fiscal year 1948 as a sale of assets. The amount of \$1,473.93 in cash was also received from Story and Sons and that sum was credited to their account on the books of the corporation. Likewise, the corporation received the sum of \$2,099.91 from Las Vegas Supply Co. for the sale of certain miscellaneous assets which was credited on the corporation books. The amount of \$1,786.16 was received from Clark and credited to him in the "Accounts Receivable—Officers" account. There is no evidence that the cash items totalling \$6,610 were deposited in the corpo-

ration's bank account as a part of the deposit of March 31, 1948, or at any other time.

Gene Clark, Inc., constructed a swimming pool at LaJolla, California, for James M. Young, Jr., and received the following checks:

Date	Amount
10/30/47	\$1,672.75
11/26/47	1,672.75
11/6/47	1,672.75
1/24/48	1,902.73

The first three checks listed above were credited to the account receivable ledger card of James M. Young. It was conceded on brief that the last check in the amount of \$1,902.73, endorsed by petitioner, was neither recorded on the books of the corporation, deposited in its bank account, nor reported as income on its tax return for fiscal 1948.

Petitioner, on behalf of Gene Clark, Inc., received the following checks for plumbing material sold by the corporation to the Valley Cities Supply Co.:

Date	Payable to	Endorsed by	Amount
9/20/47	Gene Clark	Gene Clark, Archie Koyl	\$2,731.54
6/10/48	Gene Clark	Gene Clark	1,147.00
7/21/48	Gene O. Clark	Gene O. Clark	5,000.00
8/17/48	Gene O. Clark	Gene Clark	3,000.00
11/ 8/48	Gene O. Clark	Gene Clark	2,000.00
1/24/49	Gene O. Clark	Gene Clark, Archie Koyl	1,795.55

It was stipulated that the above checks were neither entered on the books of Gene Clark, Inc., as sales, nor reported for tax purposes on either the income tax returns of the corporation or of petitioners for the years in question.

“Accounts Receivable—Officers,”

Farm Purchases

During 1946, Gene Clark took a trip to Kansas to examine some farm land, intending to purchase it for the corporation to own and operate. After locating a farm known as North Farm, in Montgomery County, Kansas, he purchased it for a total price of \$40,000, making a down payment of \$10,000 which he borrowed from the Valley Cities Supply Co. When the directors of Gene Clark, Inc., were advised that the corporation was not permitted to own such land in Kansas, they rejected the proposed purchase of North Farm. Petitioner then decided to purchase the farm land in his own name, using corporate funds as part of the consideration. As part of his financial arrangements relating thereto, petitioner, on July 31, 1946, had set up account #110 on the corporate books designated as “Notes Receivable” and an entry was made indicating a loan of \$10,000 had been extended to Clark and Koyl. Thereafter extensive withdrawals were debited to the account in 1946 in relation to the farm purchases, and will be referred to *infra*. These withdrawals were made by Clark without provision for promissory notes, security or interest. There are two credit items in 1946, which as explained by journal entry, merely reflect a transfer to another account (Outside Investment—West Covina Property). There is a debit in 1947 to Valley Cities Supply Co. which is balanced by a credit within a month. There is also a debit of \$1,591.83 dated February 28, 1947, which is unexplained. None of the

credits purport to be cash payments by Clark (or Koyl) except the \$20,000 item of April 30, 1948, in the so-called trust deeds account which was a spurious credit. The circumstances surrounding it and the use of the "Trust Deeds" as the title of the account are set forth infra in our Findings.

Originally, when it was decided that the corporation would own and operate North Farm, the board of directors had opened an account with the Citizens National Bank of Los Angeles, California, designated "Special Account No. 1," in the amount of \$5,000. However, after it was learned that the corporation could not operate the farms, on December 31, 1946, the \$5,000 deposit in said account was transferred to the "Notes Receivable—Officers" account as a debit to Clark's individual account.

Soon after the purchase of North Farm, Koyl indicated that he would like to own a farm. Petitioner thereupon bought another farm in Kansas for Koyl, known as South Farm, consisting of about 350 acres. As part of the purchase price therefor, Clark obtained approximately \$10,000 by selling plumbing materials belonging to the corporation. In addition, on August 31, 1946, a charge to the "Notes Receivable—Officers" account was made in the amount of \$11,406.80, and again on October 31, 1946, another charge of \$12,420.66 was made in connection with the purchase of the farms.

As of May 1, 1947, the "Notes Receivable" account shows debit balances of \$25,304.50 for Clark and \$10,844.79 for Koyl, totalling \$36,149.29. Said

balances were in direct proportion to their respective shareholdings in the corporation.

Some time before May 1, 1947, the designation of the "Notes Receivable — Officers" account on the general ledger was scratched out (for some unexplained reason) and changed to "Trust Deeds." A schedule denominated "Notes Receivable — Officers," attached to the corporation's return for fiscal year 1947, states, *inter alia*, that after it was learned that North Farm in Kansas could not be purchased by Gene Clark, Inc., the corporation extended a loan to the officers and "authorized the Officers to purchase this land in their names. The corporation received in return Trust Deeds and Signed Notes [Sic] as security until such time as the land can be profitably sold." At no time while Clark was affiliated with the corporation did it own any trust deeds, and except for the erroneous heading of the account, the corporate books do not reflect such ownership.

In 1948, petitioners purchased two other farms in Kansas for a total price of \$70,000, and for such purpose borrowed \$28,000 from the Independence Bank in Kansas on February 5, 1948, payable in five years. The loan was repaid September 26, 1950.

In March 1949, title to South Farm, owned by Koyl, was transferred to Clark.

Pursuant to the specific instructions of petitioner, the comptroller sometimes made entries in the corporate books which did not reflect the true facts or amounts involved in the particular transactions being recorded. Thus, during 1948, when Gene

Clark, Inc., declared its first and only formal dividend, petitioner received a dividend check in the amount of approximately \$20,000 (to be exact \$19,996.17). Petitioner reported the receipt of the dividend on his joint return for 1948. On April 30, 1948, after Clark received the dividend check, his "Notes Receivable—Officers" account was credited with \$20,000. Petitioner, however, did not turn back the dividend check to the corporation as a credit toward said account. Instead, Clark turned over to the corporation comptroller customers' checks, substantial in amount, totalling about \$20,000, with instructions to credit said account.

Matters Relating to Earnings and Profits Available for Distribution

The deficiencies in the instant case were predicated upon the computations contained in an exhaustive report prepared by respondent's agent during the investigation of the income tax liability of Gene Clark, Inc., for the fiscal years 1947 through 1950, inclusive, the report being admitted in evidence by stipulation of the parties to show the basis of respondent's determination. Corporate net income and tax liability were computed largely upon the bank deposit method, gross receipts being determined primarily on the basis of unreported sales and deposits in the various bank accounts of the corporation. Also, numerous deductions reported by the corporation on its returns as ordinary and necessary business expenses were disallowed.

Respondent, being unable to ascertain with exactitude the amounts of diverted funds attributable to Clark and Koyl, respectively, during the years in issue, allocated such diversions on the basis of their respective stock ownership in said corporation, 70 per cent of the unreported corporate funds being attributed as informal or constructive dividends to petitioners.

The manner in which respondent determined those amounts ultimately attributed to the officer-stockholders as informal dividends for each of the years in question was to first ascertain the earnings and profits of the corporation, as indicated above, and then to adjust this figure for so-called "unavailable" items, thus arriving at the amount "actually" available for distribution as constructive dividends.

Many items included in the revenue agent's report were admitted by counsel for petitioner to be correct at the time the report was submitted in evidence and in part are set forth in detail above in our Findings relating to unreported transactions. A number of other items connected with the unreported sales of the corporation were contested by petitioner, either at the trial or on brief.

Our Findings of Fact with respect to those items relating to earnings available for distribution which are in dispute (except for items disposed of in our Opinion, *infra*, because of failure of petitioner to sustain the burden of proof and items already fully covered in our Findings) are as follows:

(1) Corporate earnings per return

The net income per return of the corporation, as set forth hereinbefore, is properly includible in computing earnings available for distribution as dividends for each of the taxable years in controversy.

(2) Substitutions

As aforementioned, during the years 1946 through 1949, inclusive, substantial amounts of receipts from sales were neither recorded on the books of Gene Clark, Inc., nor reported in its income tax returns. In some instances, no part of the particular sales was recorded or reported. In others, less than the full amount was recorded or reported. One device used was referred to in the testimony as "substituted" sales. The device operated substantially as follows: Cash sales would be made and recorded on the books. Other sales totalling a like amount would be made, for which checks were received in payment, which were not recorded on the books. The proceeds of the latter sales, though not recorded, would be deposited, but the recorded cash sales would not be deposited. As a result, the deposit would equal the recorded sales, but an equal amount of sales would be unrecorded and unreported.

Petitioner also cashed checks as an accommodation for neighborhood stores and workmen in relatively small sums ranging up to \$100, and an undisclosed number of such checks were deposited in the various corporate bank accounts.

Apart from such "accommodation" checks, the

aforementioned checks, representing unreported sales, were "substituted" for the "cash receipts" and deposited in corporate bank accounts, and are includible in corporate gross income. We have reduced the amount of the substituted items on the basis discussed *infra* in our Opinion. The amounts reflected in the revenue agent's report, and the amounts as adjusted by us are as follows:

Fiscal Year	Amount per Report	Amount as Adjusted
1947	\$14,806.77	\$13,326.10
1948	35,419.36	30,892.36
1949	8,074.79	7,267.31

(3) Creed credit allowance

As noted above, between December, 1945 and March, 1946, petitioner performed plumbing work for Y. L. Creed, a general contractor, on several houses. Creed paid a total of \$2,922.50 therefor, of which the first payment was paid to the Plumbing Co., in the sum of \$544 on February 5, 1946. The balance of \$2,378.50 was credited to petitioner by Creed in June of 1946, at which time Clark purchased a house from him for a total consideration of \$8,500. The balance or credit of \$2,378.50 was not reported on the books of the corporation, or on the income tax returns of either the corporation or petitioners for any of the years in question. There is no evidence that Koyl received any benefit from this credit. In reconstructing corporate income for fiscal 1947, the revenue agent included as an unreported balance due from Creed the amount of \$3,058.50. The amount of \$3,058.50 was not income of the corporation, and we have eliminated it from corporate income. The credit

of \$2,378.50 was income to Clark and his wife on the community property basis and one-half of that amount is attributable to Clark for 1946.

(4) Truman Johnson credit allowance

During 1946 Gene Clark, Inc., purchased a house from Truman Johnson, a customer of the corporation, for a total price of \$22,000, and received a credit allowance of \$6,000 on the purchase price. The \$6,000 credit was not recorded on the books of Gene Clark, Inc., or reported on the corporate income tax returns for any year involved herein. See Findings of Fact, *supra*.

(5) "Notes Receivable—Officers"

As aforementioned, during the entire period in question the two officer-stockholders of the corporation maintained individual open accounts on the corporate books in the "Notes Receivable—Officers" account, to which extensive withdrawals were charged and partial repayments were credited. See Findings of Fact, *supra*.

The net withdrawals in the amount of \$36,149.29 from Gene Clark, Inc., as of May 1, 1947, constituted, in reality, disguised dividend distributions rather than loans to the officers during the taxable years involved herein.

(6) Income—deferred sales

During each of the taxable years in question the corporation entered into contracts with building contractors for the installation of plumbing and received a percentage of the total contract price as the work progressed. When the rough plumbing was installed, the corporation collected 80 per

cent of the total contract price from the contractors, of which 30 per cent was carried on the corporate books as deferred income until the contract was completed.

In a schedule attached to its Federal income tax return for fiscal 1947, the corporation explained the account as follows:

Deferred Income-Advance On Contract Sales:

This account is based on plumbing contracts not completed. On the installation of rough plumbing, fifty per cent of full contract price is set up as income, in as much as half of the contract terms have been completed. However, after installation of rough plumbing, eighty per cent of full contract price is collected from customer as per terms of the contract. (50% complete—80% collected). This additional thirty per cent collected from the customer at this period of the contract is carried on the books of Gene Clark Incorporated as deferred income until the contract has been completed. After the installation of finish plumbing has been completed, the remaining fifty per cent of contract price is set up as income and the remaining twenty per cent of contract price is collected from customer. This procedure of accounting has been consistently maintained by Gene Clark Incorporated in order not to overstate income in relation to cost of sales of each contract. At the installation of rough plumbing, it is established that the cost of the contract at this period, consisting mainly of labor, is on the average, fifty per cent of contract cost. Whereas, the cost of the contract on installation

of finish plumbing consists mainly of materials, also established to be on the average fifty per cent of contract cost.

The so-called deferred income for fiscal 1947 disclosed in the return, but not included in gross income, was in the amount of \$49,210.15. The revenue agent included the amount in adjustments to corporate income for fiscal 1947 but excluded it from earnings available for distribution in that year, and included it in available earnings for fiscal 1948.

(7) Pacific Pump, Inc.

During fiscal 1948, Gene Clark, Inc., received a check from Pacific Pump, Inc., (of which E. J. Weiss was president) for plumbing supplies in the amount of \$1,094.52. The check was included in corporate sales for 1948, but was improperly designated in the journal ledger as having been received from E. J. Weiss. In reconstructing corporate income for fiscal 1948, the revenue agent erroneously included the check as an unreported sale to Pacific Pump, Inc.

(8) Bad debts

On its tax return for fiscal year 1947, the corporation deducted as bad debts the sum of \$4,874.51 from its gross income. Of said amount, \$3,703.50 was disallowed in fiscal 1947 (no identifiable event establishing worthlessness having been proven by the corporation), and was included as "disallowed bad debts" in adjustments to corporate income for that year. The same sum of \$3,703.50 was then deducted by the revenue agent from total corpo-

rate net income available for distribution during fiscal 1947, on the theory that said amount was not actually available for distribution as dividends for that year. During fiscal year 1948, the corporation recovered \$3,216.90 of the above bad debt, and reported said amount on its return. In view of the disallowance of \$3,703.50 as a bad debt deduction for fiscal 1947, the amount recovered (\$3,216.90), together with bad debt deductions allowed by the revenue agent for fiscal year 1948 in the amount of \$1,569.40, (the total of the two items being \$4,786.30) were excluded from net income for fiscal 1948 as "nontaxable income and additional deductions." The amount of \$4,786.30 was then added back to corporate earnings available for distribution during fiscal year 1948.

Facts Relating to Farm Expenditures for 1946 and 1947

In July, 1946, after the corporate directors decided not to purchase North Farm, Clark purchased the farm for himself and planted some 300 acres of wheat thereon, which was expected to mature in the spring of 1947. His father, Clyde R. Clark, managed the farm for petitioners. Because of flood conditions in the area which destroyed the crop, there was no income from the farm operations in 1946 and 1947. No deductions for farm losses incident to the operations of North Farm were claimed on petitioners' individual tax returns for 1946 and 1947.

The corporation maintained a special account in

the Citizens National Bank of Los Angeles (Maywood), California, in the amount of \$5,000 (which was set up on the corporate books on December 31, 1946, as an account receivable from petitioner), and which was used by petitioner's father in Kansas to pay certain operating expenses of the North Farm owned by Clark and also the South Farm owned by Koyl.

During 1946 the following checks were drawn on Gene Clark, Inc.'s "Special Account No. 1" and signed by Clyde R. Clark:

Date	Amount	Payable to	Item
t. 17, 1946	\$274.95	J. W. Griffith	Seed wheat—North Farm
t. 17, 1946	102.15	Lewis Griffith	Seed wheat
v. 2, 1946	21.00	North End Service Station	Gas and oil
v. 9, 1946	195.57	W. A. Thompson	Seed wheat and oats—South Farm
c. 6, 1946	590.36	A. M. Eckelberry Co.	Taxes on both farms
c. 6, 1946	36.50	Clyde R. Clark	Repairing fences on South Farm

In addition to the above expenditures, between November 8, 1946, and December 13, 1946, salary checks in the total amount of \$950 were drawn on the special account payable to Clyde R. Clark.

Of the foregoing items, we find that the following were ordinary and necessary business expenses of operation of the North Farm for 1946:

Seed wheat	\$274.95
Taxes	223.24
Salary	475.00

Total—1946 \$973.19

During the calendar year 1947, Clyde R. Clark drew \$85 from the special account payable to E. Pincher for overhauling a truck. The check does not show that it was for the North Farm. Clyde R. Clark also drew \$200 as salary from the special account in 1947. On December 3, 1947, Gene paid taxes on his North Farm in the amount of \$223.24. For the calendar year 1947, the following were ordinary and necessary business expenses for the operation of North Farm: Salary \$100; taxes \$223.24.

The parties stipulated that petitioners sustained losses on their farm operations in Kansas during the taxable years 1948 and 1949 in the amounts of \$17,233.05 and \$17,060.52, respectively, and that said losses will be reflected in the Rule 50 computation.

Adjusted Basis—Partial Liquidating Dividend

In his statutory notice for 1948, respondent determined that petitioner received a partial liquidating dividend from Gene Clark, Inc., in the amount of \$65,095.94 during that year. For our reduction of this amount, see our Opinion, *infra*. In this connection, respondent determined that the adjusted basis of petitioner's 522 shares of stock in the corporation was \$52,100. The parties have stipulated that the basis of petitioner's 522 shares was \$61,214.49.

Ultimate Findings—Limitations and Fraud

With respect to calendar years 1945 through 1949, inclusive, the statutory notice was mailed to

petitioners on February 20, 1953. No agreement extending the statute of limitations on assessment or collection was entered into between the parties for the taxable years 1945, 1946, or 1947. With reference to the taxable years 1948 and 1949, the parties have stipulated that the statute of limitations is not an issue.

Each of the returns of Gene Clark for the years 1946 and 1947 was false and fraudulent with intent to evade tax within the meaning of section 276(a) of the Internal Revenue Code of 1939. A part of the deficiency of Gene Clark for each of the years 1946 and 1947 was due to fraud with intent to evade tax within the meaning of section 293(b).

Faye Clark filed her individual Federal income tax return for the calendar year 1946 on March 15, 1947, reporting thereon gross income in the amount of \$14,651.66. She filed her return for the taxable year 1947 on March 15, 1948, and reported gross income in the amount of \$9,130.51. The notice of deficiency for the years 1946 and 1947 was mailed to her on February 20, 1953. Respondent concedes that her returns for 1946 and 1947 were not false or fraudulent with intent to evade taxes.

Faye Clark omitted from gross income in her return for 1947 an amount properly includible therein which is in excess of 25 per cent of the amount of gross income stated in her 1947 return.

Opinion

I. Burden of Proof—Deficiencies.

We discuss the burden of proof as to deficien-

cies at this point to avoid repetition as we progress.

The burden of proof rests with petitioner to show error in respondent's determination of deficiencies. In *American Pipe & Steel Corporation v. Commissioner*, 243 F. 2d 125, (C.A. 9, 1957) affirming this Court's opinion at 25 T.C. 351, the Court of Appeals said, in part:

Petitioner having invoked the jurisdiction of the Tax Court, entered the hearing with the duty of establishing by at least a preponderance of the evidence that the determination made by the Commissioner was erroneous.

By stipulation of the parties, the revenue agent's report was received in evidence for the purpose of showing the basis of respondent's determination, but not as proof of the facts therein set forth. Petitioner's approach to the case is an attack on many of the adjustments made in the report. Respondent, for the most part, argues in favor of the adjustments made by the agent (reflected in the ultimate determination) but in some respects disagrees therewith on brief, as will appear from our discussion, *infra*. The issues are crystalized by the contentions of the parties centering around the report, or are otherwise apparent in the record.

Our own practical approach to a resolution of the issues presented is to consider those items of the report with respect to which one or another of the parties expressly disagrees, together with those which evolve upon a consideration of the record as a whole. The remaining items, with respect to which petitioner has failed to point to error, and has not

met his burden of proof will be reflected in our ultimate determinations, but will not be separately or specifically considered. As it is, our Opinion is protracted to unusual length because of the many issues actually in dispute, the numerous accounting details involved, and the complexity of reconciling and applying the various conclusions we have reached.

II. Understatement of Income—1946

For the year 1946, we are concerned only with the tax liability of Gene Clark, since assessment and collection for that year are barred by the statute of limitations as to Faye Clark.

The respondent, in his statutory notice of deficiency, determined that Clark had failed to report informal dividends received from Gene Clark, Inc., in the amount of \$44,227.13. His approach in making this determination was first to calculate the earnings of the corporation for the fiscal year ending April 30, 1947. He attributed 70 per cent of this amount to Clark as the owner of 70 per cent of the stock of said corporation. Petitioner's return was filed on a calendar year basis. Respondent attributed 84.259 per cent of Clark's share to calendar year 1946, (see discussion *infra*) and divided the amount thereof equally between Gene and Faye Clark, who filed separate returns for 1946 on a community property basis.

As already stated, the burden of proof of error is upon petitioner. Petitioner, however, citing *Helvering v. Taylor*, 293 U.S. 507, (1935) contends

that respondent's determination is arbitrary and excessive and therefore must fall in its entirety. In support of this view, petitioner urges that the amount of corporate earnings actually received by Clark in money or property was not established, and that the allocation to calendar 1946 of part of the net earnings of the company for fiscal 1947 available for distribution was without rational foundation.

In *Greenwood v. Commissioner*, 134 F. 2d 915 (C.A. 9, 1943) affirming this Court's decision in 46 B.T.A. 832, the Court of Appeals said (p. 919):

"Unquestionably the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid" (*Helvering v. Taylor*, 1935, 293 U.S. 507, 515 * * *), which burden is sustained by a clear showing that the determination was arbitrary or erroneous.

Later (p. 922) the Court said:

Petitioner has failed to overcome the presumption of validity attaching to the determination of the Commissioner, * * *.

We think it apparent that petitioner's view is unacceptable. It is manifest from the evidence that substantial amounts of income of the corporation were unrecorded on its books and unreported for tax purposes by the corporation. Respondent had ample reason to infer that such money and property were retained for personal use by Clark or Koyl or both. The respondent had no means of ascertaining the precise amounts involved or the exact amounts withheld by Clark or Koyl because

of the very fact that no records were kept and that the transactions were purposefully concealed. It is clear from the record that Clark was the chief perpetrator of the various schemes calculated to siphon off corporate earnings and was well aware of what was going on. In the circumstances of this case, where petitioner admittedly withheld large sums of corporate earnings, it was reasonable for respondent to infer that Clark had seen to it that he retained his share in some approximate relationship to stockholdings. Obviously, petitioner's difficulty is of his own making in failing to keep records of amounts admittedly extracted from corporate funds, regardless of the asserted purpose of the withdrawals. In the absence of records, the respondent was obliged to resort to some reasonably effective technique for the determination of income, and petitioner cannot, by devising such concealment, deprive respondent of the right to use a practical method of making his determination, which he is forced to adopt because of such concealment. We believe the methods adopted by him and the results reached were not arbitrary under the circumstances. *Jack M. Chesbro*, 21 T.C. 123, 128 (1953), affirmed (C.A. 2, 1955) 225 F. 2d 674. The allocation of distributions to the calendar year 1946 will be discussed *infra*.

Counsel for petitioners also complain that no net worth computation was offered by respondent for corroboration or comparison. We rejected the identical argument of counsel under similar circumstances in *United Dressed Beef Co.*, 23 T.C. 879

(1955), on appeal (C.A. 9, Dec. 29, 1955), holding that respondent is under no obligation to make such a computation. Moreover, petitioner could have offered evidence of net worth if he believed it would show error in respondent's computation, but did not do so.

We also reject petitioner's argument that virtually all understatements of gross income derived from unreported corporate sales are offset by over-ceiling payments for scarce commodities on the black market made by him on behalf of Gene Clark, Inc., and that any profits derived from the resale of such commodities ultimately inured to the sole benefit of said corporation. We think there were some over-ceiling purchases and resales, but we do not believe that the purchases account for substantially all of the diversions, and there is nothing to suggest that the proceeds of any resales or the profits therefrom were ever turned in to the corporation or were accounted for in any of the income tax returns. Clark, of course, suggests nothing in the way of amounts. We do not believe his vague and general testimony, and there is no corroboration of his statements except the limited evidence of Files (largely based on statements made to him by Clark) that he knew that some such transactions took place. Files had no knowledge of the amounts of purchases or resales. Clark has fully demonstrated that he is unworthy of belief and it is not surprising that his testimony with respect to records he purportedly kept of alleged black market purchases was vague and unconvincing. Files did

not know of any records kept by Clark showing amounts expended for black market purchases. We are convinced that any books or records obtained by revenue agent Stutzman from petitioner during the course of the investigation of the tax liability of the corporation and its stockholders were all returned to Clark. In any event, petitioner was able to offer only one specific instance of a transaction involving black market activities. While, as already stated, we believe that some illicit purchases were made by petitioner, there is no credible evidence as to whether the full cost thereof was or was not included in computing cost of goods sold on the corporate tax returns involved. Of even greater significance is the lack of any evidence that the profits from resale of illicit purchases were ever recorded on the books of the Company or reported in its income tax returns. Clark himself admitted that profits from over-ceiling sales made through Gene Clark Plumbing as a front for the corporation were never recorded on the books of either Plumbing Company or the corporation, and were not reported in any of the income tax returns. All this being true, the record affords no basis for making a reasonable estimate of amounts expended on behalf of the corporation which would justify a deduction or elimination from income. Paul Masters, 25 T.C. 1093, 1100 (1956), affirmed 243 F. 2d 335 (C.A. 3, March 28, 1957); Jack M. Chesbro, *supra*, 129.

Petitioner claimed at the trial and in his opening brief that Plumbing Co. and Gene Clark, Inc.,

coexisted after April 23, 1946, as two separate and distinct business enterprises, and therefore not all the unreported sales in question were properly attributable to the corporation. Whether the unreported sales were, in the first instance, those of the Plumbing Co. or of the corporation is a question of fact. See *Miller-Smith Hosiery Mills*, 22 T.C. 581 (1954); *United Dressed Beef Co.*, *supra*, 886. We are satisfied that none of the unreported sales in controversy were reflected in the corporate returns, and the Plumbing Company filed no returns for this period.

It is our view that both organizations were treated as a single entity. Indeed, petitioner testified that after the corporation commenced operations, Plumbing Co. existed in reality only as a conduit to protect the former (which had the license to do business) from possible prosecution for violation of O.P.A. regulations. Petitioner, on reply brief, refers to the testimony of Clark to the effect that "all proceeds received from the sale of inventory which he believed belonged to Gene Clark Plumbing Company ended up in the hands of Gene Clark, Inc." Petitioner then concludes in said brief "the sole taxable entity was the corporation." Respondent likewise takes the position that all sales after May 1, 1946, were by or on behalf of the corporation. Thus, both parties appear to agree with our view that the enterprises were merged into a single entity, Gene Clark, Inc., and the profits are attributable to it whether recorded and reported or not. It goes without saying, however, that to

the extent such profits were diverted to Clark, they are likewise taxable income to him.

(1946-A) Computation of Understatement

We turn next to the computation of the understatement for 1946. The revenue agent's report was received in evidence by agreement of the parties for the limited purpose of explaining the basis for respondent's determination. The total adjustment to net income of Gene Clark, Inc., for fiscal 1947 as recapitulated in the agent's report was \$102,050.17. Although the agent, in his report, recognized that the net income per corporate return for fiscal 1947 (\$30,632.10) should be reflected in addition to the above amount of \$102,050.17, he failed, by some inadvertence, to add the net income per return in his recapitulation. Giving effect to net income per return, we reach a figure of \$132,682.27. From this amount, we deduct \$3,058.50 in accordance with our Findings of Fact eliminating the Creed transaction from corporate earnings. (It is to be noted, however, that the credit of \$2,378.50 in that transaction was income to Clark and his wife on the community property basis.) We next deduct \$1,480.67 for cashing of accommodation checks per discussion, *infra*. We also deduct \$48,694.38 as accrued Federal income taxes of Gene Clark, Inc., for fiscal year 1947, calculated on the basis of net income before taxes (\$128,143.10) as reconstructed by the agent after the adjustments we have made. The agent was in error in failing to accrue such taxes. *Estate of Esther M. Stein*, 25 T.C. 940 (1956). The remaining

earnings (\$79,448.72) were available for distribution on the basis of the foregoing. The agent deducted \$63,488.47 on the theory that the items which together total that figure were "not available" for distribution in fiscal 1947. We find no basis for this view. Our reasons will be set forth *infra*. The significant issue is the year in which these items are to be taken into account rather than the amounts themselves. Contra adjustments relating to this group of items for fiscal 1948 will be discussed later in connection with that year.

Respondent determined that Clark received taxable dividends of \$44,227.13 from Gene Clark, Inc., for 1946, half of which (\$22,113.57) was taxable to him on the community property basis. The explanation of the determination, based on the revenue agent's report, is that the corporation as a result of the diversions to Clark and Koyl, in effect distributed to them \$74,984.96 as ordinary dividends during fiscal 1947; that 84.259 per cent thereof (\$63,181.62) is allocable to calendar year 1946; and that \$44,227.13 (70 per cent of \$63,181.62) is attributable to Clark, who was the owner of 70 per cent of the stock.

As indicated above, respondent determined that one-half of \$44,227.13 (or \$22,113.56) is taxable to Clark on the community property basis as income for 1946, and a like amount is taxable to his wife. We will discuss *infra* the various adjustments and the objections raised by petitioner. Suffice it to say at this point that petitioner has failed to meet the burden of proving that respondent's determina-

tion was excessive and we therefore affirm his determination by adding \$22,113.56 to Clark's income for the year 1946. We recognize that the revenue agent's report is taken by the parties as the substantial basis for respondent's determination. We also recognize that the revenue agent erred, for example, in failing to accrue taxes of the company for fiscal 1947, and that there are minor adjustments to be considered *infra*. These errors were adverse to petitioner's interest. There were, however, also errors in his favor (such as the so-called "unavailable" items totalling \$63,488.47). It is clear that all such errors may be corrected and that, if the circumstances warrant it, respondent may be affirmed in a proper case for reasons other than those which he, himself, has assigned. *John I. Chipley*, 25 B.T.A. 1103, 1105-6 (1932). See also *James P. Gossett*, 22 B.T.A. 1279, 1284 (1931) affirmed 59 F. 2d 365 (C.A. 4).

Since the available earnings for fiscal 1947 which we have calculated above (\$79,448.72) exceed the amount shown in the revenue agent's report (\$74,984.96), we think we should add the following statement. Respondent has filed no claim for an additional deficiency for 1946. Even if such a claim were filed, however, we could not find an additional deficiency on the record before us. The burden of establishing such an additional deficiency would be upon the respondent. Our affirmance of the deficiency determined in his statutory notice is based in material respects upon petitioner's failure to meet his burden of proof. There is insufficient af-

firmative evidence in the record, however, to find an additional deficiency, with respect to which the burden shifts to respondent.

For like reasons, we point out that although we have calculated earnings available for distribution for fiscal 1947 in an amount in excess of respondent's determination of actual distributions for fiscal 1947, there is no basis for carrying the excess over into fiscal 1948 as earnings available for distribution in that year. Respondent has made no determination to that effect, and it is not supported by affirmative evidence.

(1946-B) Items Totalling \$63,488.47 Available
for Distribution in Fiscal 1947.

As indicated *supra*, we have eliminated the agent's deduction for fiscal 1947 of the total amount of \$63,488.47 in calculating earnings available for distribution (but allow corresponding adjustments for fiscal 1948). Five items comprise the above amount, and we consider each.

(1) Truman Johnson—\$6,000. As set forth in our Findings, Gene Clark, Inc., was credited with \$6,000 by Johnson in 1946. The item was for plumbing materials and services rendered by Gene Clark, Inc. The credit was applied to a house purchased by the company from Johnson in 1946. It was never recorded on the books of the company or reported for income tax purposes. It is clearly an income item to the company and is as much includible in available earnings as any other item of income. The availability of earnings is not depend-

ent upon the form of the asset by which they are represented. There is no requirement that the income be in cash or any particular tangible form, or that it may be distributed only in the form in which it is earned. Internal Revenue Code 115(a) and (b); Regulations 111, section 29.115-2.

(2) H. L. Brittain—\$1,860.40. Petitioner does not appear to contest inclusion of this item in the company's income for fiscal 1947. His position is that it was not "available for distribution," but offers no support for his view other than that the agent so treated it. Respondent, on brief, takes the position that this (as well as the other items in the group totalling \$63,488.47) was available for distribution. We agree with this view for the same reasons as those discussed in paragraph (1) above.

(3) So-called deferred sales income—\$49,210.15. The underlying facts relating to this item are set forth in our Findings and need not be repeated here. We think it is clear that the so-called deferred sales income of \$49,210.15 was properly included by the agent in the company's income for fiscal 1947, and should not have been deferred by the company until fiscal 1948. The amount was not only accrued, but actually collected in fiscal 1947. Petitioner does not appear to disagree with the view that the item should be treated as income for fiscal 1947. His position is rather that a corresponding reserve should be set up in fiscal 1947 and that the amount thereof be treated as not available for distribution in that year, at the same time admitting it would be available in fiscal 1948. For

the reasons stated in paragraph (1) above, we think it as available as any other income in fiscal 1947. We agree in this respect with respondent's position on brief. Petitioner further urges that the item should not be deemed available in both years. With this we agree, and a contra adjustment will be made in relation to fiscal 1948.

(4) Merchandise purchases—\$2,714.42. The agent disallowed merchandise purchases in the total amount of \$2,914.42 for lack of substantiation. Petitioner has offered no evidence of substantiation. One of the items comprising the total of \$2,914.42 was a check to Koyl in the amount of \$200. The agent, however, reduced available earnings by \$2,714.42 (not reflecting the Koyl check). We think it clear that neither the amount of \$2,714.42 nor the \$200 item were properly deducted from available earnings. No reason to the contrary is suggested. Respondent, on brief, resists the deduction from available earnings, and we agree. The effect of the disallowance is to increase net earnings, all of which were available for distribution for the reasons set forth in paragraph (1) above.

(5) Bad debts—\$3,703.50. The agent disallowed the deduction of bad debts in the amount of \$3,703.50 on the ground that worthlessness had not been established. Petitioner failed to establish worthlessness. The agent, nevertheless, reduced available earnings by the amount which he disallowed. Again respondent argues on brief that the reduction should not have been made, and again we agree. Likewise, as in paragraph (4) above, the

effect of the disallowance is to increase net earnings, all of which are available for distribution for the reasons set forth in paragraph (1) above.

(1946-C) Corporate Net Income
per Return—Fiscal 1947

In our computation of understatement for 1946, we included in corporate earnings for fiscal 1947 available for distribution as dividends the amount of the company's earnings reported on its return. (We deducted corporate income taxes, however, including taxes on income reported.)

Petitioner contends that the corporate earnings in the amount of \$30,632.10 reported on the original return of Gene Clark, Inc., for that period, should be deducted from earnings available for distribution as dividends. Referring to his "analysis" of such earnings, he argues that the net income per return was retained in the business, and hence was not distributed to anyone. To support his position, petitioner points out that the revenue agent, in his computation of income available for distribution as dividends, did not include therein the amount of net income per return. Respondent, on the other hand, insists that the corporate income per return should properly have been treated as part of earnings available for distribution, despite the revenue agent's failure to include them.

Examination of the revenue agent's report reveals that he computed the total net income (excluding "notes receivables" and "other investments") to be \$132,682.27, and that this amount

specifically included the corporate income per return for fiscal year 1947. See Joint Exhibit 3-C, Schedule 1, p. 5. For some unexplained reason, however, the agent, in setting up his schedule of distributions to stockholders, failed to use said amount as a starting point in computing the total net income available for distribution as constructive dividends. Instead he used only "net adjustments" to corporate income in the amount of \$102,050.17. Joint Exhibit 3-C. Schedule Q, p. 81.

The revenue agent obviously erred in this respect. We believe respondent's view on brief is the proper one, and we hold that the corporate earnings per income tax return must be included in available earnings. In his refutation of petitioner's attack on the correctness of the deficiency, respondent is not to be restricted to the computations or theory of the revenue agent. The agent's report was received by agreement merely to explain the basis for the ultimate statutory determination. As already pointed out, it discloses errors favorable as well as adverse to petitioner. We are not limited to the correction of errors only when it is to the advantage of petitioner for us to do so. Respondent has an equal right to our consideration. Petitioner was fully aware of the issue and no element of surprise is present. In all events, there is no doubt in our mind that we have the authority (and duty) under the circumstances of the instant

case to correct the error in question. See James P. Gossett, *supra*; John I. Chipley, *supra*.

We think there can be no doubt as indicated *supra*, that under the statute all accumulated net earnings and profits of Gene Clark, Inc., less accrued income taxes for fiscal 1947, were available for distribution as dividends and that the form of assets in which such earnings were reflected or distributed is immaterial. Internal Revenue Code 115(a) and (b); Regulations 111, section 29.115-2. Petitioner cites no authority to the contrary.

Needless to add, the fact that earnings are available for distribution does not mean they were actually distributed. The availability of earnings is material only to the question of whether actual distributions are to be treated as ordinary income or otherwise. Here, respondent has determined that distributions were made to petitioner and, as already stated, petitioner has failed to meet the burden of proving the contrary or that the amount so determined was excessive for 1946.

(1946-D) Substitutions

Petitioner would further reduce earnings available for distribution as dividends for fiscal year 1947 by the amount of so-called "substituted items in bank deposits" of the corporation in the sum of \$14,806.77. In reconstructing corporate income by the bank deposits method, the revenue agent included as additional gross receipts all checks which were not reported as sales or otherwise accounted

for on the books of the corporation. Upon examination of the original bank deposit slips, he discovered certain checks listed thereon, which were deposited but which did not correspond in amounts with the items in the "cash receipts" records of the corporation, and therefore, concluded that such checks constituted substitutions for cash items purportedly deposited, but actually diverted by the officer-stockholders. The underlying facts are set forth in our Findings.

The revenue agent concluded that the corporation had additional unreported sales during fiscal 1947 in the amount of \$83,960.08, of which \$14,806.77 represented such substitutions, and that the corporation failed to report on its return said sum for 1947. The amount of \$14,806.77 was therefore added to adjustments to net income for that year. The testimony of the comptroller with respect to the handling of checks and cash receipts, while general in nature and not directed to particular items, supports respondent's position. Files testified that at various times during the period in question Clark gave him checks made out to the corporation by customers for sales, which were unreported on the corporate books, in exchange for amounts of cash taken by petitioner which had been reflected on the books but had not been deposited. The checks were thereafter deposited in the corporation's bank accounts. Petitioner does not deny that substitutions occurred, but claims that any cash taken by him in connection with unrecorded sales was used by him for over-ceiling purchases. He

produced no records to support such use or the amounts which he expended for such purchases, and admits that he did not record or report the resale of any such purchases or the profits therefrom.

It is clear, also, that since the cash receipts from sales per books and sales reported in the company's income tax return reconciled in total amounts, and both reconciled in total amount with actual deposits, the unrecorded checks must have been substituted in the deposits for other items of cash which were recorded on the books but were not deposited.

Petitioner has failed to meet the burden of proving error in respondent's determination in this respect (as explained on the basis of the revenue agent's report), except to the extent set forth below.

Petitioner claims that some of the funds for which substitutions were made were used to cash checks for the accommodation of customers and employees. The testimony of Files supports the fact that accommodation checks were cashed, and the revenue agent's report shows the deposit of a number of small checks ranging up to \$100. The record does not disclose the amount of such accommodation checks. Nevertheless, where, as here, there appears to be a right to an allowance, but the amount is not shown, we are warranted in allowing what we think is an appropriate amount, resolving all doubts against the petitioner who is responsible for any inadequacies of proof. Cohan

vs. Commissioner, (C.A. 2, 1930) 39 F. 2d 540. We hold, therefore, that \$1,480.67, which is 10 per cent of the amount considered to be "substituted" checks in fiscal 1947 represented "accommodation" checks and as indicated in our "(1946-A) Computation of Understatement," supra, we have made an appropriate adjustment in determining corporate earned surplus.

(1946-E) Y. L. Creed

Petitioner urges that the revenue agent, in reconstructing corporate income for fiscal 1947 improperly included unreported sales to Creed in the amount of \$3,058.50 when the balance due Gene Clark, Inc., was only \$2,378.50. The underlying facts relating to this disputed item are set forth fully in our Findings of Fact. On the basis of our Findings, it is clear that \$3,058.50 is to be eliminated from corporate earnings for fiscal 1947. We have already made this allowance in our Opinion under the heading "(1946-A) Computation of Understatement." It is equally clear from our Findings, however, that the credit allowed Clark by Creed in 1946 in the amount of \$2,378.50 was income to Clark and his wife for 1946, one-half thereof being attributable to Clark individually.

(1946-F) "Notes Receivable—Officers"

Account—\$36,149.29

A further difference between the parties relates to the inclusion of the "Notes Receivable" account

in the amount of \$36,149.29 in the dividends distributed to Clark and Koyl for fiscal 1947. Petitioner contends that the withdrawals debited to said account in the above amount represented a series of "loans" to the two officer-stockholders and, therefore, were not properly treated as dividends distributed to them. Respondent, on the other hand, maintains that the withdrawals represented diversions of corporate funds to Clark and Koyl, and were in fact informal or constructive dividends to them.

The issue is one of fact and the intention of the parties is controlling. *Carl L. White*, 17 T.C. 1562, 1568 (1952). Many criteria have been used by the courts as aids in determining the intention of the parties. No one factor is alone conclusive. We must look to substance rather than to form. Neither the language nor the formalities followed preclude us from determining the true nature of the transaction. *William C. Baird*, 25 T.C. 387 (1955), and cases cited therein. The absence of any promissory notes (although the account was headed "Notes Receivable") or security, and the failure to charge or pay interest, while not conclusive against petitioner on the basic issue, are factors to be considered. On the other hand, the treatment of the withdrawals on the corporate books as "Notes Receivable" and the references thereto in the corporate minutes and tax returns are likewise to be considered but are not controlling, since it is established that book entries or records may not be used to

conceal realities as a means of relieving the taxpayer from liability for income taxes. Ben R. Meyer, 45 B.T.A. 228, (1946); and cases cited therein. The statement attached to the company's return for fiscal 1947 relating to "Notes Receivable—Officers" is not only obviously self-serving, but is clearly inaccurate in material respects. (See particularly the reference to trust deeds, which Clark admits were never executed.)

The following additional facts are, we think, of significance. The withdrawals of Clark and Koyl recorded in "Notes Receivable—Officers" (later "Trust Deeds") account were, on February 28, 1947, in exact proportion to their stock interests and consistent with their agreement to share in corporate earnings and profits. William C. Baird, *supra*. The funds of the company so withdrawn were primarily used as part of the purchase price of two Kansas farms, one for Clark, and the other for Koyl. It is important to note that the first purchase (North Farm) was for Clark, and that thereupon Koyl "indicated that he would like to own a farm." The second tract (South Farm) was then bought in Koyl's name. The company funds made available therefor debited to Clark and Koyl in proportion to their stockholdings, were, we think, evidently used by them in an evening-up arrangement for their own benefit and in proportion to their interests.

Upon consideration of all of the evidence material to this issue, we are convinced that the with-

drawals in issue during fiscal 1947 in the amount of \$36,149.23 were not intended to be loans, but were, in reality, diversions of corporate funds by the officer-stockholders, taxable as dividends to them. *Estate of Helene Simmons*, 26 T.C. 409 (1956). As already determined, *supra*, there were sufficient earnings available for distribution to cover the foregoing amount. Of that amount, \$25,304.50 is attributable to Clark, and is part of the dividends determined by respondent to have been distributed to him for fiscal 1947. The computation relating thereto is included in our discussion *supra* under the heading “(1946-A) Computation of Understatement.”

Petitioner further contends that the agent added the notes receivable item of \$36,149.29 in computing the net income of Gene Clark, Inc., for fiscal 1947, and urges error in this respect. While the agent's report is complicated, and in some respects confusing, we do not understand from it that he intended to increase net income by that amount. Whether he did or not, we, in our own calculation of net income as well as earnings available for distribution, did not include the item of \$36,149.29, so that we have given effect to petitioner's contention. See “(1946-A) Computation of Understatement,” *supra*.

(1946-G) Other Investments—\$273.97

Petitioner contends that this item was likewise added by the agent to net income of Gene Clark,

Inc., for fiscal 1947. We do not think the agent intended to do so, but again, whether he did or not, we did not include the item in our own calculation of net income or earnings available for distribution. See "(1946-A) Computation of Understatement," *supra*.

(1946-H) Allocation of Constructive
Dividends to 1946

Petitioner contends that respondent was arbitrary in allocating constructive dividends of \$63,181.62 to Clark and Koyl for 1946 out of total constructive dividends of Gene Clark, Inc., for fiscal 1947 in the amount of \$74,984.96. The ratio allocated to 1946 was 84.259 per cent. Eight months of the company's fiscal year was in 1946 and four months in 1947. (While petitioner does not admit any constructive dividends for the period, he does not dispute, assuming there were such dividends, an allocation of 70 per cent to Clark and 30 per cent to Koyl according to their proportionate stock interests.) Clark's share for 1946 was determined to be \$44,227.13.

Petitioner has failed to establish that his share for 1946 was actually less (or greater) than the amount determined. He merely points to the fact that only two-thirds of the company's fiscal year was in 1946.

We find no basis for holding that the allocation was arbitrary. We do not know the rationale on which it was based, and there is no occasion for us

to speculate on it. Petitioner made no motion to require respondent "to file a further and better statement" (Tax Court, Rules of Practice, Rule 17(c)(1)), as a basis for challenging the allocation. No authorities are cited or reasons offered by petitioner to support his theory that the allocation, to be rational, must in this case be proportionate to the number of months of the corporation's fiscal year which fall in the taxpayer's calendar year. While, as above stated, we have no reason to speculate concerning respondent's reasons, we point out, if only for suggestive consideration, that the withdrawals from "Notes Receivable—Officers" (which we have held to be dividends) reached the substantial net amount of \$34,557.46 as of December 31, 1946, and increased only \$1,591.83 between that date and April 30, 1947, the end of the company's fiscal year. In all events, although, as stated, the burden is on petitioner, the record offers some affirmative support for respondent's action in weighing the particular allocation by attributing the larger percentage to 1946. We think petitioner has failed to prove that the allocation was erroneous or arbitrary, and there is no basis for holding it invalid. *Greenwood v. Commissioner*, *supra*.

(1946-I) Farm Losses

While our Findings of Fact are dispositive of this issue, some explanation of our views appears in order.

Clark and Koyl each bought a farm. Clark's

was known as the North Farm, and Koyl's as the South Farm. The expenditures in issue were all by checks, signed by Clark's father, and charged to a special account. Obviously, only those attributable to North Farm could be deductible. The evidence supports the conclusion that Clark's father at least managed the North Farm, but since some of the expenditures handled by him were for each farm, it is inferable that he also managed, or participated in the management of the South Farm. The evidence does not establish otherwise. The evidence likewise fails to establish that the salary paid to him (drawn on the special account by him) was solely attributable to his management of the North Farm. The basic bank deposit in the special account was \$5,000 which was made from corporate funds, but was debited to "Note Receivable—Officers."

With this background, we have allowed or disallowed farm expenditures for 1946 as follows:

We allow the deduction of the check dated October 17, 1946, for \$274.95 on which the notation appears "Seed wheat—North Farm."

We disallow check of the same date for \$102.15 because there is no evidence that it was expended for North Farm.

The check of December 6, 1946, in the amount of \$590.36 was for taxes on both farms. We allow a deduction of \$223.24 which was the amount of taxes paid on North Farm for the following year. While

the tax for 1946 may have varied slightly either way, we do not think the variation could be sufficient to require a different approach.

We disallow the check dated December 6, 1946, for \$36.50 because the check itself shows that the expenditure was for South Farm.

We disallow the check dated November 2, 1946, for \$21 because there is no evidence that it was expended for North Farm.

The check dated November 9, 1946, for \$195.57 is disallowed because it appears from the check that the expenditure was for South Farm.

We allow \$475 for salary to Clark's father, which is one-half of the total salary drawn by him for 1946. There is no evidence that the total salary of \$950 was exclusively for services in managing North Farm, or that more than half of that amount was for such services. We feel justified in allowing \$475, as above set forth because the evidence, though vague, indicates that at least half of his attention was directed to management of North Farm. See *Cohan v. Commissioner*, *supra*. One-half of the farm allowances are attributable to Gene, and one-half to Faye on the community property basis.

III. Understatement of Income—1947
(1947-A) Adjustment of Long-Term
Capital Gain

For the calendar year 1947, respondent, in his

statutory notice of deficiency, determined that Gene Clark realized a long-term capital gain of \$105.15 from the sale of a residence in lieu of \$304.75 reported on his return, and accordingly decreased the gain thereon, one-half of which was attributed to each petitioner as separate income. Petitioners claim no further adjustment with respect to this item.

(1947-B) Constructive Dividends From Gene Clark, Inc., Fiscal Year 1947.

In accordance with our discussion of the year 1946, under the heading "(1946-A), Computation of Understatement," it is apparent without repeating our analysis that Clark's share of constructive dividends from Gene Clark, Inc., for fiscal year 1947, attributable to Clark and his wife on the community property basis, is \$8,262.34. This is 70 per cent of the difference between the total dividends of \$74,984.96 attributable to both Clark and Koyl from fiscal 1947 less \$63,181.46, attributed to calendar year 1946 as dividends to them for that year. One-half of \$8,262.34 is taxable income to Clark for 1947, and a like amount is taxable income to his wife.

(1947-C) Revenue Agent's Adjustments relating to Gene Clark, Inc., Fiscal 1948

Following immediately is Schedule A, which summarizes the adjustments made by the revenue agent in relation to Gene Clark, Inc., for its fiscal year

ending April 30, 1948. The parties have agreed that the revenue agent's report be received in evidence for the purpose of showing the basis for respondent's ultimate determination. We will consider, under succeeding headings the various issues specifically disputed, including those relating to the adjustments actually made, and those affecting net income or earnings available for distribution which are not referred to by the revenue agent.

Schedule A

Summary of Revenue Agent's Adjustments Relating to Gene Clark, Inc.,

Fiscal Year Ended April 30, 1948

	Gene Clark		Archie Koyl	
	1947	1948	1947	1948
	Total			
Adjustment to Net Income	\$ 92,208.62			
Reversal FYE April 30, 1947—deferred income	49,210.15			
Assets distributed per alleged sale	3,409.91			
Recovery of Bad Debts	4,786.30			
Truman Johnson item	6,000.00			
Total	<u>\$155,614.98</u>			
Adjustments to Net Income not available	6,381.15			
Total distribution per RAR	<u>\$149,233.83</u>			
		\$43,376.22	\$18,589.81	\$24,309.43
		<u><u></u></u>	<u><u></u></u>	<u><u></u></u>
		\$62,958.37		
		<u><u></u></u>		

Amount charged against surplus in Exhibit I of this report:		
Gene Clark—1947	\$ 41,238.65	
Archie Koyl—1947	17,673.70	
Partial liquidating dividends:		
Gene Clark—1947	\$43,376.22	
Less: Amount charged against surplus	41,238.65	
	<hr/>	
Gene Clark—1948	\$ 2,137.57	
	62,958.37	
	<hr/>	
Archie Koyl—1947	\$18,589.81	
Less: Amount charged against surplus	17,673.70	
	<hr/>	
	\$ 916.11	
	\$24,309.43	
	<hr/>	
Archie Koyl—1948	25,225.54	amount carried to Schedule 1A in concurrent RAR on Archie M. and Fawn A. Koyl
	<hr/>	
Total distribution per RAR	\$149,233.83	
	<hr/>	
Amount carried to Schedule 5 in concurrent RAR on Gene O. Clark:		
Amount carried forward from		
FYE 4/30/1947	\$ 8,262.34	
Amount charged against surplus		
FYE 4/30/1948	41,238.65	
	<hr/>	
Total	\$ 49,500.99	
	<hr/>	

(1947-D) Corporate Net Income per Return,
Fiscal 1948

The revenue agent recognized that net income per return for fiscal year 1948 in the amount of \$16,726.40 should be reflected in addition to the increases set up in his adjustments (\$92,208.62) but again failed to include the income per return in his recapitulation. For the same reasons as those set forth under the heading "(1946-C) Corporate Net Income per Return—Fiscal 1947", we hold that corporate net income per return for fiscal 1948 must be given effect in determining total net income of Gene Clark, Inc., for the fiscal year in question.

(1947-E) Increased Sales

Included in the agent's adjustments to income were increased sales in the net amount of \$81,995.71. The gross increase was \$131,205.86 which the agent reduced to \$81,995.71 by properly allowing a contra deduction of \$49,210.15 which was included in the company's net income for fiscal 1947.

While petitioner does not concede any of the items, he raises specific objections only with respect to those discussed in the following subparagraphs.

(1) Substitutions. The first group of items, totaling \$35,419.36 are referred to as "substituted items," and are of the same nature, and determined in the same manner, as those discussed *supra* under the heading "(1946-D) Substitutions." The burden of proof is on petitioner to show error in respondent's determination, which is explained by the revenue agent's report, received in evidence by stipula-

tion of the parties. Moreover, as already appears in our Findings, and as analyzed in our discussion under 1946-D, *supra*, there is affirmative testimony (although much of it is general in nature) as well as circumstantial evidence, which in many respects supports respondent's determination. Except as indicated below, petitioner has not offered any acceptable evidence to the contrary, and does not deny that substitutions were made. His claim that he used any cash from unrecorded sales to make over-ceiling purchases again is not substantiated in fact (except to the limited extent of Files' testimony already referred to under the heading "Understatement of Income—1946'") or in amount. Again he did not account for any proceeds or profits from over-ceiling resale of any such purchases. Since petitioner has failed to show error, except as indicated below, we hold for respondent on this group of items, subject to the adjustments we make below, for the same reasons as those advanced under 1946-D, *supra*, which we have no occasion to repeat here.

We now discuss the particular substituted items to which petitioner specifically objects.

(a) We eliminate the item of \$1,094.52 relating to Pacific Pumps, Inc., which, as shown by our Findings in subparagraph (7) under the heading "Matters Relating to Earnings and Profits Available for Distribution," was a duplication by the agent due to an incorrect designation in the journal ledger as having been received from E. J. Weiss, who was president of Pacific Pumps, Inc.

(b) We agree with the agent's treatment of three checks from Hamilton Homes, Inc., in the respective amounts of \$1,221, \$2,295, and \$2,170. As set forth in our Findings these checks were received by the company for plumbing material and services. They were not included in the sales of the company. The first two checks were deposited in the company's bank account on September 16, 1947, as part of a total deposit of \$21,180.51. The third check was deposited in the company's account as part of a deposit in the amount of \$10,016.46. In the light of all of the evidence in the record as to substitutions, and particularly in view of the fact that the cash receipts from sales per books and sales reported in the company's tax return reconciled in total amounts, and both reconciled in total amounts with actual deposits, the only possible inference is that the Hamilton Homes, Inc., checks, which were deposited but not included in sales, were substituted for other receipts included in sales but not deposited. Petitioner has failed to meet the burden of proving otherwise.

(c) For the same reasons assigned in subparagraph (b), above, we agree with the agent's treatment of check of \$1,000 received from H. K. Niles. This check was not included in sales, but was included in the bank deposit of September 16, 1947, the total deposit being \$21,180.51.

(d) With alike factual background, and for the same reasons, we agree with the agent's treatment of a check in the amount of \$6,670 received from Southern California Investment Company. The

check was endorsed "Gene Clark, Inc., Gene Clark" and was cashed on March 19, 1948. A cashier's check in the same amount was acquired on the same date and was deposited in the company's bank account on March 31, 1948, as part of an over-all deposit of \$12,816.85. The receipt of the \$6,670 was not recorded in sales. Our Findings cover additional attending circumstances showing the receipt of \$6,610 from four different transactions which were recorded on the books of the company, but there is no evidence that the receipts totalling \$6,610 were deposited in the company's bank account.

(e) On the basis of our discussion in subparagraphs (a) to (d) inclusive, the only adjustment we have made is to reduce substituted items by \$1,094.52, as set forth in (a) above, giving a net amount of substitutions to this point of \$34,324.84. From this we again deduct 10 per cent (\$3,432.48) to allow for cashing of accommodation checks, resulting in a final net addition to income for substituted items in the amount of \$30,892.36. Petitioner has made no specific objections to the items included in substitutions other than those discussed above, and has not met his burden of proof with respect thereto.

(2) Other items—increased sales. With respect to items of increased sales, other than those discussed under substitutions (subparagraph 1, above), petitioner makes concessions as to the following: He admits on brief that \$38,009.74 was received from George Meissenburg (Valley Boulevard Plumbing

and Electric Company), and that said amount was not reported on the tax return of Gene Clark, Inc., or on the return of Clark, and that the partnership filed no return. He likewise admits on brief that a check dated January 24, 1948, in the amount of \$1,902.73 "was not reported as taxable income by the corporation (as it should have been); it was not reported in the corporation's bank account nor was it recorded on the corporation's books." He has also stipulated that the items relating to Allen T. Mitchell & Sons (\$2,294.50), A. & F. Plumbing and Heating Co. (\$1,158.44) and Ben Lang (\$1,558.44) were not entered on the company's books or reported for income tax purposes by the company or by petitioner.

As to all other items which the agent included in increased sales, while petitioner makes no express concessions, he likewise establishes no error, and we have found none.

(3) Summary—increased sales. On the basis of the discussion under subparagraphs (1) and (2) above, we reduce the computation of increased sales from the net amount \$81,995.71 to \$77,468.71.

(1947-F) Adjusted Net Income, Gene Clark,
Inc., Fiscal 1948

Petitioner establishes no error with respect to adjustments to the company's net income for fiscal 1948, other than factors considered supra, and our examination thereof likewise discloses no errors except those adjusted by us above. The agent's total net adjustments to net income of the company was

\$92,208.62. Our adjustments to increased sales, *supra*, reduce this amount by \$4,527, resulting in net adjustments, as revised, (and before adding corporate net income per return) in the amount of \$87,681.62. To this, for the reasons stated above, we add corporate net income per return in the amount of \$16,726.40, resulting in a final net income figure for the company for fiscal 1948 of \$104,408.02.

(1947-G) Earnings Available for Distribution as Ordinary Dividends, Gene Clark, Inc., Fiscal 1948.

In addition to adjustments to net income, the agent adds a number of items in computing earnings available for distribution. We consider them in the following subparagraphs.

(1) Deferred income. The agent treats the amount of \$49,210.15 as available for fiscal 1948. The item itself was included as income in fiscal 1947, and we agreed that it was properly so includible. The agent, however, treated it as unavailable for distribution in fiscal 1947. We held that he was in error in this respect, and found that it was available for distribution in that year. (See 1946-B (3), *supra*.) Consistent with our holding, we eliminate it from earnings available in fiscal 1948.

On the other hand, the agent eliminated from available earnings for fiscal 1948 the amount of \$6,381.15, which was the total of the Ben Lang item of \$1,300.75 and advance on contract sales in the amount of \$5,080.40. We think the agent likewise erred in eliminating these items. The Ben

Lang item was included in sales for fiscal 1948 (the agent transferring it from fiscal 1949) and the advance on contract sales was the same type of deferred income as the item of \$49,210.15. We think both are includible in available earnings for fiscal 1948 for the same reasons as those discussed supra under 1946-B(1) and (3). Contra adjustments will, of course, be considered for fiscal 1949.

(2) Assets distributed per alleged sale. The agent treats an amount of \$3,409.91, labeled "Assets distributed per alleged sale" as an addition to available earnings. Petitioner objects, and on the record before us, we must agree with petitioner. The agent's explanation is as follows:

Sale of depreciable business assets claimed per return as losses from said sales have been disallowed in the amount of said losses in Exhibit G of this report. The sales were not made to the third parties whose names appeared in the books of the taxpayer, but were distributed in kind to an officer or officers of the taxpayer.

Assuming, arguendo, that the statement of the agent is supported by affirmative evidence, we do not think it supports an addition to available earnings as such. The proper treatment would be to restore the disallowed losses in determining net income. We cannot tell from the agent's report whether he had done so or not, although there is some indication from an item in his adjustments, similar in amount, but not identical, that he has. If he has, the addition of \$3,409.91 to available earnings would be a duplication. If he has not, we

can only say that there is nothing in his report which would warrant us in holding that the respondent has actually determined that net income is to be increased by this item. We may add that respondent has not clarified the issue on brief.

(3) Recovery of bad debts. The revenue agent increased available earnings by the amount of \$4,786.30. Of this amount, \$3,216.90 resulted from the collection of part of the sum of \$3,703.50 which was disallowed as a deduction for fiscal 1947 (see 1946-B(5) *supra*) and was used to increase net income and available earnings for fiscal 1947. It must, therefore, be eliminated from the calculations for fiscal 1948 to avoid duplication. The balance of \$1,569.40 represents allowances of bad debt deductions of \$1,266.40 (H. L. Brittain) and "Bad debt allowance — other accounts reversed in previous year" (\$303). We find no basis for holding that the \$1,569.40 is to be used to increase available earnings for fiscal 1948.

We accordingly eliminate the entire amount of \$4,786.30 from the agent's adjustments to available earnings.

(4) Truman Johnson—\$6,000. We included this item as part of net income and available earnings for fiscal 1947. (See 1946-B(1), *supra*.) It must, therefore, be eliminated from the calculations for fiscal 1948, to avoid duplication.

(5) Accrued taxes and additions to tax. In determining earnings of Gene Clark, Inc., available for distribution as ordinary dividends for fiscal 1948, the agent failed to accrue Federal income

taxes for fiscal 1948 or additions to tax under section 293(b) for fiscal 1947. Each of these items should have been accrued. Estate of Esther M. Stein, *supra*. The respective amounts thereof are \$39,399.42 and \$19,979.69.

(6) Summary — earnings available for distribution—fiscal 1948. The total net income of Gene Clark, Inc., as finally adjusted, for fiscal 1948 was \$104,408.02. (See 1947-F, *supra*.) From this we deduct the total accruals set forth in subparagraph (5) above, in the amount of \$59,379.11, leaving a balance of earnings available for distribution as ordinary dividends in the amount of \$45,028.91.

(1947-H) Distributions, Gene Clark, Inc.,
Fiscal 1948

The revenue agent's report sets up a total distribution for fiscal 1948 of \$149,233.83. It is clear that in doing so, he included and reflected the total amount of \$63,406.36 which we have eliminated in 1947-G(1), (2), (3) and (4), *supra*. We must, therefore, deduct the latter amount, leaving net distributions of \$85,827.47. We realize, of course, that he did not include in his calculation corporate earnings per return, and that he eliminated the item of \$6,381.15 referred to by us in 1947-G(1), *supra*. While it was appropriate for us to reflect these items in determining earnings available for distribution as ordinary dividends, we cannot use them to increase actual distributions as reflected in respondent's final determination. On the other hand, while we deducted accrued taxes for fiscal

1948 and additions to tax under 293(b) for fiscal 1947 in determining earnings available for distribution as ordinary dividends, we do not reduce actual distributions by the amount of taxes and additions to tax because actual distributions may, and often do, exceed available earnings, the excess being in the nature of liquidating dividends.

Other than the adjustments we have made above, petitioner has failed to meet the burden of proving error in respondent's determination. Accordingly, we accept the figure of \$85,827.47 as representing total distributions. We apply this first to the amount of \$45,028.91, earnings available for distribution as ordinary dividends. The balance of \$40,798.56 will be treated as a liquidating dividend, (*Drybrough v. Commissioner*, 238 F. 2d 735, (C.A. 6, 1956), affirming in part and reversing on another issue *United Mercantile Agencies, Inc.*, 23 T.C. 1105) but since the part thereof allocable to Clark, (being 70 per cent thereof — \$28,558.99) does not equal the basis of his stock, it is not material as to his or his wife's taxes for 1947. It will be discussed *infra* in connection with calendar years 1948 and 1949.

Of the amount of \$45,028.91 (available earnings), we attribute 70 per cent (\$31,520.24) to Clark. Our reasons for so doing are apparent from our prior discussion, which need not be repeated here, especially since the agent uses this ratio and petitioner's testimony shows that he received a minimum of 70 per cent of whatever earnings were distributed.

The actual distributions calculated above (\$85,-

827.47) must first be applied to the earnings available for distribution as ordinary dividends in the amount of \$45,028.91, of which \$31,520.24 is attributable to Clark. On any appropriate basis of allocation of distributions (\$85,827.47) from fiscal 1948 to calendar 1947 (which included eight months of fiscal 1948), the distributions attributable to calendar 1947 would be at least sufficient to encompass total ordinary dividends including the \$31,520.24 attributable to Clark. We accordingly attribute the entire amount of ordinary dividends distributed to Clark for the company's fiscal 1948 to Clark's calendar year 1947.

We have no occasion to allocate the amount of \$40,798.56 treated as liquidating dividends (or the amount of \$28,558.99 attributable therefrom to Clark) as between calendar 1947 and calendar 1948, because it is not material to calendar 1947, since the cost of Clark's stock was not exceeded thereby in 1947.

(1947-I) Ordinary Dividend Distributions to
Clark for Calendar 1947

On the basis of the discussion in paragraphs 1947-B to 1947-H, inclusive, there was distributed to Clark for calendar year 1947 (to be accounted for by him and his wife on the community property basis) ordinary (constructive) dividends totalling \$8,262.34 from Gene Clark, Inc., allocated from fiscal 1947, and like dividends of \$31,520.24 from the same company allocated from fiscal 1948. The total is less, of course, than the amount of \$49,-

500.99 determined by respondent in his statutory notice of deficiency.

(1947-J) Farm Losses

With the background of our discussion under 1946-I, *supra*, we think it apparent that our Findings are dispositive of this issue, allowing a deduction of \$100 for salary to Clyde R. Clark, and \$223.24 for 1947 taxes. As to the check for \$85 for overhauling a truck, neither the check nor the oral evidence establishes that the payment was related to the operation of the North Farm.

The items allowed are attributable one-half to Gene and the other half to Faye on the community property basis.

IV. Income—1948

(1948-A) Net Income, Gene Clark, Inc., Fiscal 1949

(1) Corporate net income per return. The income tax return of Gene Clark, Inc., for fiscal 1949 showed a loss of \$4,154.03.

(2) Adjustments to net income. The agent, in his report (received in evidence by stipulation as explanatory of respondent's ultimate determination) makes adjustments in the total amount of \$46,575.16, which he treats as income of the company for fiscal 1949. We discuss the adjustments in the following subparagraphs.

(A) Unreported sales. The agent increases sales by a net figure of \$30,836.68. In arriving at this amount, he correctly eliminated the Ben Lang item of \$1,300.75 and "Advance on Contract Sales" in

the amount of \$5,080.40, both of which items we (and the agent) included in income for fiscal 1948 (although the agent erroneously eliminated them from available earnings for fiscal 1948). See 1947-G (1), *supra*.

(i) Substituted items. \$8,074.79 of the increase in sales was attributed to substituted items in the agent's report. From this we deduct \$807.49 for cashing of accommodation checks. See discussion under 1946-D, *supra*. As to the balance of \$7,267.30, petitioner has failed to meet the burden of proving error, and we have found none. We accordingly approve inclusion of the latter amount in unreported sales.

(ii) Additional unreported sales. With respect to additional unreported sales, petitioner makes some concessions on brief. He lists a total of \$16,064.84 in checks from Valley Cities Supply Co., all within fiscal 1949. He then makes the following statement:

The foregoing checks, totalling \$16,064.84, were issued by Valley Cities Supply Company to Gene Clark for merchandise, except that check No. 659, for \$1,795.55, was issued to Gene Clark, Inc. That check was cashed and the proceeds used to purchase two cashiers checks; one to Gene Clark in the sum of \$1,034.33, and the other to Gene Clark, Inc. for \$761.22. The check for \$761.22 was deposited in the corporation's bank account and was recorded in its books. It was reported in the income tax return as gross income for the fiscal year ended April

30, 1949. The other checks were either cashed or were used to purchase cashiers checks which were not deposited in the corporation's bank account, nor reported in its income tax return.

The agent did not include the item of \$761.22 in unreported sales.

With respect to the remaining items of unreported sales, petitioner establishes no error and we have found none.

(iii) Summary—unreported sales. On the basis of the discussion in paragraphs (1) and (2) above, we reduce the unreported sales from \$30,836.68 to \$30,029.19. Petitioner has failed to meet the burden of proof of error in respondent's ultimate determination in this respect, as explained by the revenue agent's report, except to the extent of the adjustment which we have made.

(B) Disallowance of cost of goods sold. The agent disallowed a total of \$10,216.72 for which deduction had been taken on the corporate return as cost of goods sold. Two checks of \$45.99 and \$226.50 comprising part of the foregoing were disallowed as personal, family or living expenses of the officers of the corporation. The remaining check of \$9,994.23 was payable to Archie Koyl, and was disallowed as cost of goods sold for want of substantiation.

Petitioner has again failed to meet the burden of proof of error in relation to such disallowances which, as explained by the revenue agent's report, are reflected in respondent's ultimate determination.

(C) Other adjustments to net income. Petitioner does not appear to question, and has failed to meet the burden of proving error, in (1) disallowance of compensation of officers in the amount of \$2,499.91; and (2) disallowance of other expenses in the amount of \$3,021.85.

(D) Summary—net income. On the basis of our discussion in paragraphs (A), (B) and (C) above, we reduce the agent's adjustments to net income from \$46,575.16 to \$45,767.67. The agent, however, failed to reflect the loss per corporate income tax return. We, therefore, make a further reduction of \$4,154.03, as a result of which corporate net income for fiscal 1949, after our adjustments, is \$41,613.64.

(1948-B) Earnings Available for Distribution
as Ordinary Dividends for Fiscal 1949

Subject to the adjustments which we make below, the corporate net income of \$41,613.64 is available for distribution as ordinary dividends for fiscal 1949. See discussion under 1946-B(1), *supra*.

(1) Erroneous additions to and eliminations from available earnings. The agent increases available earnings by an item of \$1,300.75 relating to Ben Lang, and an item of deferred income of \$5,080.40. We have already held that these items are includible for fiscal 1948 (see 1947-G(1), *supra*) and they must be eliminated in determining available earnings for fiscal 1949.

On the other hand, the agent deducts an item of \$7,976.11, which has been included in income for

fiscal 1949 as advance on contract sales. We hold that the agent has erroneously deducted this amount in calculating available earnings for fiscal 1949 on the basis of our discussion under 1946-B (3), *supra*.

(2) Accrual of taxes and additions to tax. In determining earnings of Gene Clark, Inc., available for distribution as ordinary dividends for fiscal 1949, the agent failed to accrue Federal income taxes for fiscal 1949 or additions to tax under section 293(b) for fiscal 1948. Each of these items should have been accrued. Estate of Esther M. Stein, *supra*. The respective amounts thereof are \$14,555.23 and \$17,826.18, or total accruals of \$32,381.41.

(3) Summary — earnings available for distribution, fiscal 1949. The total net income of Gene Clark, Inc., as finally adjusted by us was \$41,613.64. (See 1948-A(2)(D), *supra*.) From this we deduct the accruals set forth in 1948-B(2) above in the amount of \$32,381.41, leaving a balance of earnings available for distribution as ordinary dividends in the amount of \$9,232.23. As will appear *infra*, in discussing actual distributions for fiscal 1949, it is apparent that on any tenable basis for allocation as between calendar years 1948 and 1949, an amount in excess of \$9,232.23 would be allocable to 1948. Distributions for fiscal 1949 must first be applied to available earnings, so that the full amount of \$9,232.23 is attributable to calendar 1948. Since Clark was the owner of 100 per cent of the stock from prior to April 30, 1948, until March

1, 1949, it likewise follows that the entire \$9,232.23 (less than the amount determined by respondent) is to be deemed distributed to him for calendar 1948. It is to be noted, however, that he included in the joint return for 1948 a dividend from Gene Clark, Inc., in excess of \$9,232.23, so that on the record before us there was no understatement of dividends on the 1948 return.

(1948-C) Distributions, Gene Clark, Inc.,
Fiscal 1949

Respondent determined that Clark received unreported dividends for fiscal 1949 in the total amount of \$26,233.75 (of which he attributed \$23,351.09 to calendar 1948 and \$2,882.66 to calendar 1949). He classified the entire amount as taxable dividends. It is clear, however, that (to the extent we find that actual distributions were made) any excess of such distributions over available earnings must be held to be liquidating dividends to be applied against the cost of Clark's stock.

It is apparent from the revenue agent's report that he eliminated the item of \$7,976.11 referred to by us in 1948-B(1), *supra*. While it was appropriate for us to reflect this item in determining earnings available for distribution as ordinary dividends, again (as in 1947-H, *supra*) we cannot use it to increase actual distributions as reflected in respondent's final determination. On the other hand, it is equally clear that the agent did include and reflect in the amounts distributed the Ben Lang item of \$1,300.75 and the deferred income item of

\$5,080.40 which we included in the prior year. (See 1948-B(1), *supra*.) We must, therefore, deduct the total of these amounts (\$6,381.15) from the amount determined (\$26,233.75) leaving a balance of \$19,852.60 as actual distributions. For the reasons stated in 1947-H, *supra*, we do not further reduce actual distributions by accrued taxes or additions to tax.

Except for the adjustments we have made, petitioner has failed to meet the burden of proving error in respondent's determination of the amount of distributions for fiscal 1949.

Of the total distributions of \$19,852.60, we have treated \$9,232.23 as ordinary dividends to Clark for calendar 1948 leaving a balance of \$10,620.37 yet to be considered. Clark, however, ceased to be a stockholder on March 1, 1949. He was owner of 100 per cent of the stock for ten months of fiscal 1949. We must, therefore, attribute to him only five-sixths of the total distributions of \$19,852.60, or \$16,543.83. The difference of \$3,308.77 must be deducted from the balance of \$10,620.37 above referred to, leaving \$7,311.60 to be treated as a liquidated dividend to Clark which will be applied against the cost of his stock. Since this amount, when added to \$28,558.99, similarly attributed for fiscal 1948 (see 1947-H) does not equal the cost of Clark's stock, there is no capital gain resulting from the liquidating dividends, which, however, will be further considered in relation to calendar 1949.

(1949-D) Farm Losses

Respondent originally disallowed farm losses of \$17,233.05 for 1948, but by stipulation, the amount thereof has been allowed.

(1948-E) No Understatement for Calendar 1948

In the light of the entire discussion of income for the calendar year 1948, we find upon the record before us no understatement of income upon the joint return of Clark and his wife for that year.

V. Income—1949**(1949-A) Farm Losses**

Respondent originally disallowed farm losses of \$17,060.52 for 1949, but, by stipulation, the above amount has been allowed as a deduction. Likewise, by stipulation, it was agreed that petitioner sustained a net operating loss for 1950 in the amount of \$4,513.62, and that said amount is properly allowable as a loss carry-back to the year 1949.

(1949-B) Interest Unreported

Respondent determined unreported interest for 1949 in the amount of \$242.49. Petitioner assigns no error with respect to this item.

(1949-C) Ordinary Dividends

Respondent determined unreported ordinary dividends from Gene Clark, Inc., in the amount of \$2,882.66. On the basis of the discussion under 1948-B(3) and 1948-C, both *supra*, we hold that petitioner received no ordinary dividends from

Gene Clark, Inc., in 1949, all ordinary dividends as determined by us from the corporation for fiscal 1949 being attributed to calendar 1948.

(1949-D) Gain on Exchange of Gene Clark,
Inc., Stock

As of March 1, 1949, Clark sold or exchanged all of the stock of Gene Clark, Inc. The selling price, per return, was \$70,747.76. The agent reduced this by \$36,149.29 (representing distributions treated as dividends in prior years) and his report shows a recognized gain of \$34,598.47, on the theory that Clark had exhausted his cost in prior years.

The parties have stipulated that the cost of said stock was \$61,214.49. On the basis of our prior discussion, the only amounts by which said cost is to be reduced are liquidating dividends of \$28,558.99 (see 1947-H, *supra*) and \$7,311.60 (see 1948-C, *supra*). These amounts total \$35,870.59, leaving unrecovered cost in the amount of \$25,343.90. On the basis of the foregoing, the gain recognized was only \$9,254.57. Since the reported recognized gain from the sale of said stock exceeded \$9,254.57, there was no understatement of capital gain for 1949.

(1949-E) No Understatement for Calendar
Year 1949

On the basis of our discussion of income for the calendar year 1949, on the record before us, we find no understatement on the joint return for Clark and his wife for that year.

VI. Fraud

General

Respondent concedes that the individual returns of Faye Clark for the years 1946 and 1947 were not false and fraudulent with intent to evade taxes, and that no part of any deficiency in her taxes for either of said years was due to fraud. He contends, however, that the returns of Gene Clark for 1946 and 1947, and the joint returns for 1948 and 1949, were false and fraudulent with intent to evade taxes (section 276(a)), and that some part of each deficiency in respect thereof was due to fraud (section 293(b)).

Since we have found no deficiency with respect to the years 1948 and 1949, we limit our discussion of fraud to the individual returns of Gene O. Clark for 1946 and 1947.

Respondent has the burden of establishing fraud by clear and convincing evidence. *Arlette Coat Co.*, 14 T.C. 751 (1950). It is not incumbent upon respondent to prove that the entire deficiency was based on fraud as a basis for sustaining additions to tax under section 293(b), which requires only that "some part" of the deficiency be due to fraud.

Our conclusions as to fraud are based upon a consideration of the entire record properly before us on that issue, and we are not limited to a consideration of respondent's affirmative evidence. *Frank Imburgia*, 22 T.C. 1002 (1954); *Wallace H. Pettit*, 10 T.C. 1253 (1948); *L. Schepp Co.*, 25 B.T.A. 419 (1931).

We recognize, of course, that fraud is not to be

predicated in any respect upon petitioner's failure to meet the burden of proving error with respect to respondent's determination of deficiencies. It must be affirmatively established that each return in question was false and fraudulent with intent to evade taxes, from the standpoint of limitations, and that some part of each deficiency is due to fraud with intent to evade taxes if additions to taxes under section 293(b) are to be approved. See *Frank Imburgia, supra*.

We will, of course, discuss the issue of fraud specifically for each of the years 1946 and 1947. It should be noted here, however, that the intent to defraud is established beyond question. Because of our extensive Findings, and previous discussion of particular items, we limit ourselves in this respect to pointing out a few of the clear and significant indicia thereof.

It is clear from the record that substantial (though undetermined amounts of receipts from sales made by Gene Clark, Inc., were neither recorded on its books nor reported on its income tax returns. It is likewise established that substantial amounts thereof passed to Clark personally. Clark, who was in general control of over-all corporate operations, admits that it was his own idea not to record certain sales as a means of withholding cash from the corporation, and that he directly participated in such diversions. On a number of occasions, Clark instructed Files, the comptroller of the corporation, to set aside cash receipts from sales and to turn the proceeds over to him without recording the

sales on the books. Clark frequently gave customers' checks for sales which were unrecorded on the books, in place of cash for like amounts which had been entered on the books, bringing about the substitutions which have been discussed *supra*. The cash went directly to Clark. Clark personally sold plumbing materials from the El Monte (main) office without accounting for or recording the proceeds on the books of the company. He also engaged in over-ceiling sales without accounting for all of the proceeds or profits therefrom. The proceeds from the many transactions summarized above were not reported in the income tax returns of either Clark or Gene Clark, Inc. Clark's explanations were largely unworthy of belief. In the main, he took the position that substantial funds, which he admitted that he took, were spent for materials and supplies, including the payment of over-ceiling charges. He had no record of the amounts which he claimed to have spent in this way and admitted not only that the books did not record his activities, but that he had not accounted for the profits from such transactions. See *M. Rea Gano*, 19 B.T.A. 518, 533 (1930).

As already indicated, we think the intent to defraud is abundantly established. We add, for completeness, that we have reached our conclusions on the issue of fraudulent intent without in any way relying upon the evidence of Clark's conviction upon his plea of *nolo contendere* for tax fraud relating to Gene Clark, Inc., for the fiscal years 1948 and 1949. It is clear that the evidence is admissible

as reflecting upon Clark's credibility as a witness (Lillian Kilpatrick, 22 T.C. 446 (1954), affirmed 227 F. 2d 240 (C.A. 5)) but even in this respect, it is obvious from the record in the instant case that he is unworthy of belief without resorting to his conviction to bolster that view.

Fraud—1946

We think that the evidence of Files with respect to unrecorded and unreported sales and diversions of corporate funds by Clark (much of which Clark himself admits, but tries to avoid by untenable explanation) gives rise to the inference of fraud for the calendar 1946. While the amounts cannot be precisely calculated, it is clear that they were substantial, and that part of Clark's deficiency for calendar 1946 was attributable thereto.

Since the corporate return for fiscal 1947 itself discloses earnings available for distribution, there appears to be no doubt that the diversions during the last eight months of the calendar year 1946 represented, at least in part, constructive dividends to Clark which were not included in the separate returns filed by him and his wife on the community property basis.

We recognize that the foregoing is based to some extent upon inference from circumstantial evidence. Needless to say, circumstantial evidence, if clear and convincing, is sufficient of itself to establish fraudulent understatements, particularly where taxpayer's failure to keep proper records makes it

difficult to pin point particular items. We, nevertheless, think it helpful to discuss two specific items in 1946, the latter of which, in all events, affirmatively demonstrates the existence of fraudulent intent.

The first is the Creed item. During the period from December 1945 to March 1946, before Gene Clark, Inc., was incorporated, Clark performed substantial plumbing work for Creed, a general contractor, for which Creed agreed to pay \$2,922.50. A payment of \$544 was made by Creed which was deposited to the account of Gene Clark Plumbing Co. and recorded in the sales of that company. The balance of \$2,378.50 was credited by Creed in June, 1946, to Clark personally, on account of the purchase price of a house which Clark was buying from Creed. The credit was not reported in Clark's income tax return or in the return for Gene Clark, Inc. Gene Clark Plumbing Co. filed no return for 1946. Clark individually got the full benefit of the payment, which should have been included in the returns of himself and his wife on the community property basis. Whether the item of \$2,378.50 is treated as a dividend (as respondent treated it) or as direct income to Clark properly received by Clark, or improperly appropriated by him for his own benefit, is here unimportant, since there were corporate earnings materially in excess of that amount available for distribution as disclosed by the corporate return for fiscal 1946. Clark received the benefit in 1946 but did not report his share of the income in his return. It is obvious that some

part of the deficiency is due to the omission of this item.

If the Creed item were considered as an isolated factor, we would be unwilling to hold that the failure to report it for income tax purposes was sufficient to establish fraud, since it might have been an oversight. When considered in the light of all of Clark's manipulations, and particularly in the pattern of the Truman Johnson item, to be discussed next, we think it is of some significance as an identifiable link in the chain of events which resulted in the understatement of income. We turn then to the Johnson item.

On October 5, 1946, Gene Clark, Inc., entered into a contract with Truman Johnson, a building contractor, to supply plumbing materials and services to Johnson on ten new houses. The transaction was handled in the following manner at Clark's request. The actual price for the materials and services was \$9,300. In the written contract, however, the price was set up as \$3,300. The difference of \$6,000 was credited by Johnson to Gene Clark, Inc., as part payment on a house which the corporation purchased from Johnson in 1946. (The house was sold by the corporation to Clark in 1947.) Johnson's books recorded the full cost of the materials and services furnished, including the \$6,000. The \$6,000 was neither recorded on the books of Gene Clark, Inc., nor reported on its income tax returns.

Here Clark's intention to defraud was deliberate and obvious. While in the first instance, the fraud from the income tax standpoint affected the tax of

the corporation, it likewise had its effect upon the income and tax of Clark arising out of diversions from the corporation by Clark, which, to the extent of the actual diversions, and not to exceed available earnings, are to be treated as ordinary dividends. Whether or not Clark was familiar with all of the income tax accounting factors involved is not material. His intent was to defraud, both as to himself and the corporation, and he succeeded.

On the basis of the foregoing discussion, we hold that Clark's individual income tax return for 1946 was false and fraudulent with the obvious intent to evade taxes, and that some part of his deficiency for 1946 (we are not concerned with how much, but the amount was undoubtedly substantial) was due to such fraud with intent to evade taxes. It follows that additions to tax under section 293(b) are to be applied for that year.

Fraud—1947

What we have said generally with respect to unrecorded sales of Gene Clark, Inc., diversions of corporate funds by Clark to himself, and failure to account therefor in his income return for 1946 applies equally to 1947. Again, however, we consider specific items.

As set forth in greater detail in our Findings, Gene Clark, Inc., in 1947, received three payments from Hamilton Homes, Inc., totalling \$5,686. These payments were not recorded as sales on the books of the company. They were deposited in the bank account of the company, but such deposits merely

substituted the Hamilton Homes, Inc., payments for payments from other customers whose payments were recorded on the books but not deposited. While Clark does not concede the particular substitution, he admits that substitutions were made from time to time. The sales per books, per returns, and the bank deposits, reconciled with each other and the only possible inference or explanation is that substitutions for unrecorded sales were made as above described. That at least a substantial part of the undeposited amounts went to Clark is obvious without repeating our analysis of the evidence. Here again, it is not significant on the fraud issue to place a label on the diversions. There were ample earnings of the company available for distribution as ordinary dividends. Thus, whether we treat the diversions as ordinary dividends or direct income to Clark, the result is the same. The income was not reported by Clark or his wife.

Since we have covered the H. K. Niles check of \$1,000 in our Findings, and since the facts and inferences as to substitution is the same as discussed with respect to Hamilton Homes, Inc., we need only say that this is another specific item, a substantial part of which was income to Clark, unreported by him or his wife.

On September 20, 1947, Clark received a check from Valley Cities Supply Co. for \$2,731.54. It is stipulated that this check was not entered on the books of Gene Clark, Inc., or reported by the corporation, or by either Clark or his wife, for income tax purposes.

On the basis of the foregoing, we hold that the income tax return of Gene Clark for 1947 was false and fraudulent, with intent to evade taxes, and that part of his deficiency for 1947 was due to fraud with intent to evade taxes. Accordingly, additions to tax under section 293(b) are to be applied.

VII. Limitations

We are concerned with the issue of the statute of limitations only with respect to the separate returns of Gene and Faye Clark for the calendar years 1946 and 1947. We take up the returns of Faye Clark first. Respondent concedes that her returns for these years were not false or fraudulent with intent to evade taxes, but has not abandoned his alternative contention that the five-year period of limitations provided for in section 275(c) is applicable to the year 1947. On this issue, the respondent has the burden of proof. *Lois Seltzer*, 21 T.C. 398 (1952).

With respect to the year 1946, we note that her return was filed on March 15, 1947, and that respondent's statutory notice of deficiency was mailed to her on February 20, 1953, more than five years later. No waiver of the statute of limitations has been filed with respect to 1946. It is thus apparent that the provisions of section 275(c) of the Internal Revenue Code of 1939 are not applicable, and since there was no fraud urged with respect to the return in question, assessment and collection of taxes are barred for 1946.

For the calendar year 1947, Faye Clark's return

was filed on March 15, 1948. The statutory notice of deficiency was transmitted to her on February 20, 1953, more than three but less than five years after the return was filed. Again, there was no waiver of limitations. Since it was conceded that there was no fraud, limitations will apply under section 275(c) unless she omitted from gross income an amount properly includible therein in excess of 25 per cent of gross income stated in the return. The gross income stated in her return was \$9,130.51, of which 25 per cent is \$2,282.63.

Since the application of section 275(c) is raised by respondent in his answer, the burden of proof is on him. He need not, however, establish a precise amount as long as it is apparent from the affirmative evidence that at least \$2,282.63 (25 per cent of Faye's gross income per return) was omitted. We think respondent has clearly met the burden of proof. We need go no further on this issue than refer to the following facts.

In part VI of our Opinion, under the heading of "Fraud—1947," we discussed the Hamilton Homes, Inc., and H. K. Niles substitutions in the respective amounts of \$5,686 and \$1,000. It is obvious that none of the checks making up these items were accommodation checks. We also discussed the Valley Cities Supply Co. check of \$2,731.54 which was neither entered on the books of Gene Clark, Inc., nor reported by the corporation, Clark, or his wife. It is clear that at least 70 per cent of the total of these amounts constituted gross income diverted from the corporation by Clark, to be accounted for

by Clark and his wife on the community property basis in their separate returns for 1947. Again, for the reasons stated in discussing the fraud issue, it is not significant whether the items be deemed direct income to Clark and his wife, or constructive dividends. They represent gross income in any event, and one-half of Clark's share of each was includible, on the community property basis, in gross income on Faye's individual return for 1947. The amount so omitted from gross income on her return which should have been included therein was well in excess of \$2,282.63, and the statute of limitations, therefore, is not a bar to assessment and collection as to Faye Clark for 1947. The question of intent on the part of Faye is not material to this issue.

With respect to Gene Clark, we hold that the returns filed by him for 1946 and 1947 were false and fraudulent with intent to evade tax, and the statute of limitations does not bar assessment and collection of any deficiency for such years. (See discussion of fraud, *supra*.) It is, therefore, unnecessary to consider respondent's alternative contention that section 275(c) is applicable to the year 1947. If it were, we think it quite evident from our discussion above relating to Faye Clark, that Gene likewise omitted an amount from gross income which was in excess of 25 per cent of the amount of gross income shown on his return, and that the bar of the statute of limitations accordingly would not apply.

The parties have stipulated that the statute of

limitations is not in issue for the years 1948 and 1949, and we have found no net understatement for those years.

VIII. Jeopardy Assessments

The record discloses that there have been certain jeopardy assessments and payments with respect thereto. It is understood that such assessments and payments will be taken into account administratively and there is no occasion for us to discuss or reflect them in our Opinion.

Decisions will be entered under Rule 50.

Served and Entered July 17, 1957.

[Title of Tax Court and Docket No. 48542.]

COMPUTATION FOR ENTRY OF DECISION

The attached computation reflecting an overpayment in Federal income tax of \$361.75 and no deficiency in penalty for the taxable year 1945; a deficiency in Federal income tax and penalty in the amounts of \$11,752.35 and \$5,876.18, respectively, for the taxable year 1946; and a deficiency in Federal income tax and penalty in the amounts of \$9,141.45 and \$4,570.73, respectively, for the taxable year 1947 (without considering the jeopardy assessments for the years 1946 and 1947 made prior to the issuance of the notice of deficiency), is submitted on behalf of the respondent in compliance with the

opinion of the Court determining the issues in this case.

The computation is submitted without prejudice to the respondent's right to contest the correctness of the decision entered herein by the Court pursuant to the statute in such cases made and provided.

/s/ NELSON P. ROSE, ECC,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
R. E. Maiden, Jr., Special Assistant to the Re-
gional Counsel, Internal Revenue Service.

Without prejudice to the right of appeal, it is agreed that the attached computation is in accordance with the opinion of the Tax Court in the above-entitled case.

/s/ THOMAS A. BAIRD,
Counsel for Petitioner.

Statement of Account

Ap:LA:AA-EWM

In re: Gene O. Clark, 304 Marguerite, Corona Del Mar, California.

Docket No. 48542

Income Tax — Year 1945

		50% Fraud	
Paid:	Tax	Penalty	Interest
March 15, 1946	\$ 141.36	None	None
Paid on joint estimated tax:			
March 15, 1945 \$	250.00		
June 15, 1945	250.00		
Sept. 15, 1945	950.00		
Jan. 15, 1946 ..	250.00		
Total	\$1,700.00		

	Tax	50% Fraud Penalty	Interest
Gene Clark's one-half ..	850.00	None	None
January 18, 1954	361.75	None	None
<hr/>			
Total paid	\$ 1,353.11	None	None
Liability	991.36	None	None
<hr/>			

Overpayment (Section 322(d)

(1)(D) of the 1939 Internal

Revenue Code) \$ 361.75 None None

Return filed March 15, 1946.

Deficiency notice dated February 20, 1953.

Claim for refund filed September 20, 1955.

Year 1946

	Tax	50% Fraud Penalty	Interest
Paid:			
March 15, 1947	\$ 1,956.75	None	None
Paid on estimated tax:			
March 15, 1946	\$199.50		
June 17, 1946	199.50		
Sept. 16, 1946 ..	199.50		
Jan. 17, 1947	199.50		
	798.00	None	None
<hr/>			
Tax withheld by employer	945.71	None	None
January 18, 1954	5,423.91	None	None
<hr/>			
Total paid	\$ 9,124.37	None	None
Liability	15,452.81	\$ 5,876.18	\$ 4,071.94
<hr/>			
Deficiency in payment	\$ 6,328.44	\$ 5,876.18	\$ 4,071.94

Year 1947

Paid:			
March 15, 1948	\$ 337.87	None	None
Tax withheld by employer	1,418.82	None	None
January 18, 1954	5,444.42	None	None
<hr/>			
Total paid	\$ 7,201.11	None	None
Liability	\$10,898.14	\$ 4,570.73	\$ 2,618.84
<hr/>			
Deficiency in payment	\$ 3,697.03	\$ 4,570.73	\$ 2,618.84

Computation Statement

Ap:LA:AA:EWM

In re: Gene O. Clark, 304 Marguerite, Corona Del Mar, California.

Docket No. 48542

Income Tax Liability

Payments on

Year		Statutory Deficiency	Jeopardy Assessments	Overpayments	
				Tax	50% Penalty
1945	Tax	None	\$ 361.75	\$ 361.75	—
	Penalty	None	None	—	None
1946	Tax	\$11,752.35	5,423.91	None	—
	Penalty	5,876.18	None	—	None
1947	Tax	9,141.45	5,444.42	None	—
	Penalty	4,570.73	None	—	None
Totals		\$31,340.71	\$11,230.08	\$ 361.75	None

Overassessment of Jeopardy Assessments

Year	Tax	Interest	50% Penalty
1945	\$ 803.89	\$ 326.76	\$ 401.95
1946	300.47	104.41	150.23
1947	2,957.26	347.19	1,478.63
Totals	\$4,061.62	\$1,278.36	\$2,030.81

The computation of tax liability shown herein is in accordance with the opinion of The Tax Court of the United States filed July 17, 1957, for decision to be entered under Rule 50.

Year 1945

It has been stipulated that there is no statutory deficiency in assessment for the year 1945 and that there is an overpayment of \$361.75. The adjustments of income and tax liability shown in the deficiency notice dated February 20, 1953, are therefore reversed.

Income tax liability	\$991.36
Income tax liability disclosed by the return, Account No. 3051314, Los Angeles District	991.36
Statutory deficiency in income tax	None
50% fraud penalty	None

	Tax	50% Fraud Penalty	Interest
Assessed:			
Liability disclosed by the original return, Account No. 3051314, Los Angeles District	\$ 991.36		
Jeopardy Spl. #5, December 24, 1952 list, Page 0, Line 0	803.89	401.95	326.76
Total assessed	\$ 1,795.25	\$ 401.95	\$ 326.76
Liability	991.36		
Overassessment	\$ 803.89	\$ 401.95	\$ 326.76

Year 1946

Adjustment to Net Income

Net income as disclosed by the deficiency notice dated February 20, 1953	36,765.23
Additional deduction:	
(a) Farm loss	486.59
Net income as revised	\$36,278.64

Explanation of Adjustment

(a) Net income is decreased \$486.59, representing allowance of deduction for farm loss. Computation of farm loss is as follows:

Income from farm	None
Deductions allowed by opinion of the Tax Court of the United States:	
Seed wheat	\$274.95
Taxes	223.24
Salary	475.00
Farm loss	\$973.19
Petitioner's community one-half	\$486.59

Computation of Tax
Year 1946

Net income	\$36,278.64
Less: Exemptions	1,500.00
<hr/>	
Income subject to tentative tax	\$34,778.64
Tentative tax	16,266.12
Less: 5%	813.31
<hr/>	
Income tax liability	\$15,452.81
Income tax liability disclosed by the return, Account No. 3039848, Los Angeles District	3,700.46
<hr/>	
Statutory deficiency in income tax	\$11,752.35
50% fraud penalty	5,876.18

	Tax	50% Fraud Penalty	Interest
Assessed:			
Liability disclosed by the original return, Account No. 3039848, Los Angeles District	\$ 3,700.46	None	None
Jeopardy Spl. #5, December 24, 1952			
List, Page 0, Line 2	12,052.82	6,026.41	4,176.05
<hr/>		<hr/>	
Total assessed	\$15,753.28	\$ 6,026.41	\$ 4,176.05
Liability	15,452.81	5,876.18	4,071.94
<hr/>		<hr/>	
Overassessment (abatable)	\$ 300.47	\$ 150.24	\$ 104.11

Year 1947

Adjustments to Net Income

Net income as disclosed by the deficiency notice dated February 20, 1953	\$33,781.21
Nontaxable income and additional deduction:	
(a) Unreported dividends	\$4,859.21
(b) Farm loss	161.62
<hr/>	
Net income as revised	\$28,760.38

Explanation of Adjustments

(a) Unreported dividends as shown by the deficiency notice	\$49,500.99
Unreported dividends per the opinion of the Tax Court of the United States	39,782.58
Decrease in unreported dividends	\$ 9,718.41
Petitioner's community one-half	4,859.21
(b) Net income is decreased \$161.62, representing allowance of deduction for farm loss. Computation of farm loss is as follows: Income from farm	None
Deductions allowed by opinion of the Tax Court of the United States:	
Salary	\$100.00
Taxes	223.24
Farm loss	\$ 323.24
Petitioner's community one-half	161.62

Computation of Tax

	Year 1947	Ordinary Rates	Alternative Tax
Net income	\$28,760.38	\$28,760.38	
Less: Exemptions	1,500.00	1,500.00	
Income subject to tentative tax	\$27,260.38	\$27,260.38	
Less: Net long-term capital gain			530.71
Balance of income subject to tax	\$27,260.38	\$26,729.67	
Tentative tax	11,521.44	11,192.40	
Less: 5%	576.07	559.62	
Tax at ordinary rates (not applicable)	\$10,945.37		
Partial tax			10,632.78
Add: 50% of \$530.71, net long-term capital gain			265.36
Alternative tax (lesser tax)			\$10,898.14
Income tax liability			\$10,898.14
Income tax liability disclosed by the return, Account No. 3050798, Los Angeles District			1,756.69
Statutory deficiency in income tax			\$ 9,141.45
50% fraud penalty			4,570.73

	Tax	50% Fraud Penalty	Interest
Assessed:			
Liability disclosed by the original return, Account No. 3050798, Los Angeles District	\$ 1,756.69	None	None
Jeopardy, Spl. #5, December 24, 1952 List, Page 0, Line 4	12,098.71	\$ 6,049.36	\$ 3,466.03
Total assessed	\$13,855.40	\$ 6,049.36	\$ 3,466.03
Liability	10,898.14	4,570.73	2,618.84
Overassessment (abatable)	\$ 2,957.26	\$ 1,478.63	\$ 847.19

[Endorsed]: T.C.U.S. Filed November 13, 1957.

[Title of Tax Court and Docket No. 48543.]

COMPUTATION FOR ENTRY OF DECISION

The attached computation reflecting an overpayment in Federal income tax of \$370.80 and no deficiency in penalty for the taxable year 1945; an overpayment in Federal income tax of \$5,470.80 and no deficiency in penalty for the taxable year 1946; and a deficiency in Federal income tax in the amount of \$9,288.48 and no deficiency in penalty for the taxable year 1947 (without considering the jeopardy assessment for 1947 made prior to the issuance of the notice of deficiency or payments made pursuant to said jeopardy assessment), is submitted on behalf of the respondent in compliance with the opinion of the Court determining the issues in this case.

The computation is submitted without prejudice to the respondent's right to contest the correctness of the decision entered herein by the Court pursuant to the statute in such cases made and provided.

/s/ NELSON P. ROSE, ECC,
Chief Counsel, Internal Revenue
Service.

Of Counsel: Melvin L. Sears, Regional Counsel,
R. E. Maiden, Jr., Special Assistant to the Re-
gional Counsel, Internal Revenue Service.

Without prejudice to the right of appeal, it is agreed that the attached computation is in accordance with the opinion of the Tax Court in the above-entitled case.

/s/ THOMAS A. BAIRD,
Counsel for Petitioner.

Ap:LA:AA-EWM

Computation Statement

In re: Faye Clark, 304 Marguerite, Corona Del Mar, California.

Docket No. 48543

Income Tax Liability

Year		Payments on			
		Statutory Deficiency	Jeopardy Assessments	Overpayment Tax	50% Penalty
1945	Tax	None	\$ 370.80	\$ 370.80	—
	Penalty	None	None	—	None
1946	Tax	None	5,470.80	5,470.80	—
	Penalty	None	None	—	None
1947	Tax	\$9,288.48	5,513.79	None	—
	Penalty	None	None	—	None
Totals		\$9,288.48	\$11,355.39	\$5,841.60	None

Overassessment of Jeopardy Assessments

Year	Tax	Interest	50% Penalty
1945	\$ 823.89	\$ 334.89	\$ 411.95
1946	12,157.33	4,212.26	6,078.67
1947	2,964.39	849.24	6,126.44
Totals	\$15,945.61	\$5,396.39	\$12,617.06

The computation of tax liability shown herein is in accordance with the opinion of The Tax Court of the United States filed July 17, 1957, for decision to be entered under Rule 50.

Year 1945

It has been stipulated that there is no statutory deficiency in assessment for the year 1945 and that there is an overpayment of \$370.80. The adjustments of income and tax liability shown in the deficiency notice dated February 20, 1953, are therefore reversed.

Income tax liability	\$ 1,121.36
Income tax liability disclosed by the return, Account No. 3056461, Los Angeles District	1,121.36
Statutory deficiency in income tax	None
50% fraud penalty	None

	Tax	50% Fraud Penalty	Interest
Assessed:			
Liability disclosed by the original return, Account No. 3056461, Los Angeles District	\$ 1,121.36	None	None
Jeopardy, Spl. #5, December 24, 1952 List, Page 0, Line 6	823.89	\$ 411.95	\$ 334.89
Total assessed	\$ 1,945.25	\$ 411.95	\$ 334.89
Liability	1,121.36	None	None
Overassessment	\$ 823.89	\$ 411.95	\$ 334.89

Adjustment to Net Income

Net income as disclosed by the deficiency notice dated February 20, 1953	\$36,765.23
Additional deduction:	
(a) Farm loss	486.60
Net income as revised	<u>\$36,278.63</u>

Explanation of Adjustment

(a) Net income is decreased \$486.60, representing allowance of deduction for farm loss. Computation of farm loss is as follows:

Income from farm	None
Deductions allowed by opinion of the Tax Court of the United States:	
Year 1946	
Seed wheat	\$274.95
Taxes	223.24
Salary	475.00
	<u>\$ 973.19</u>
Farm loss	<u>\$ 973.19</u>
Petitioner's community one-half	486.60

Computation of Tax

Year 1946

Net income	\$36,278.63
Less: Exemptions	1,000.00
Income subject to tentative tax	<u>\$35,278.63</u>
Tentative tax	\$16,591.11
Less: 5%	<u>829.56</u>
Income tax	<u>\$15,761.55</u>
Deduct:	
Deficiency in income tax barred by statute per opinion of the Tax Court of the United States	<u>11,856.85</u>
Income tax liability	<u>\$ 3,904.70</u>
Income tax liability disclosed by the return, Account No. 3039847, Los Angeles District	<u>3,904.70</u>
Statutory deficiency in income tax	None
50% fraud penalty	None

	Tax	50% Fraud Penalty	Interest
Assessed:			
Liability disclosed by the return, Account No. 3039847, Los Angeles District	\$ 3,904.70	None	None
Jeopardy, Spl. #5, December 24, 1952 List, Page 0, Line 8	12,157.33	6,078.67	4,212.26
Total assessed	\$16,062.03	\$ 6,078.67	\$ 4,212.26
Liability	3,904.70	None	None
Overassessment	\$12,157.33	\$ 6,078.67	\$ 4,212.26

Year 1947

Adjustments to Net Income

Net income as disclosed by the deficiency notice dated February 20, 1953	\$33,781.20
Nontaxable income and additional deduction:	
(a) Unreported dividends	\$4,859.20
(b) Farm loss	161.62
Net income as revised	\$28,760.38

Explanation of Adjustments

(a) Unreported dividends as shown by the deficiency notice	\$49,500.99
Unreported dividends per the opinion of the Tax Court of the United States	39,782.58

Decrease in unreported dividends	\$ 9,718.41
Petitioner's community one-half	4,859.20

(b) Net income is decreased \$161.62, representing allowance of deduction for farm loss. Computation of farm loss is as follows:

Income from farm	None
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Deductions allowed by opinion of the Tax

Court of the United States:

Salary	\$100.00	
Taxes	223.24	323.24

Farm loss		\$ 323.24
Petitioner's community one-half		161.62

Computation of Tax
Year 1947

	Ordinary Rates	Alternative Tax
Net income	\$28,760.38	\$28,760.38
Less: Exemptions	1,000.00	1,000.00
Income subject to tentative tax	\$27,760.38	\$27,760.38
Less: Net long-term capital gain		530.71
Balance of income subject to tax	\$27,760.38	\$27,229.67
Tentative tax	11,831.44	11,502.40
Less: 5%	591.57	575.12
Tax at ordinary rates (not applicable)	\$11,239.87	
Partial tax		10,927.28
Add: 50% of \$530.71, net long-term capital gain		265.36
Alternative tax (lesser tax)		\$11,192.64
Income tax liability		11,192.64
Income tax liability disclosed by the return, Account No. 3050797, Los Angeles District		1,904.16
Statutory deficiency in income tax		\$ 9,288.48
50% fraud penalty		None

	50% Fraud Tax	Penalty	Interest
Assessed:			
Liability disclosed by the original return, Account No. 3050797, Los Angeles District	\$ 1,904.16	None	None

	Tax	50% Fraud Penalty	Interest
Jeopardy, Spl. #5, December 24, 1952, List, Page 1, Line 0	12,252.87	\$ 6,126.44	\$ 3,510.19
Total assessed	\$14,157.03	\$ 6,126.44	\$ 3,510.19
Liability	11,192.64	None	2,660.95
Overassessment (abatable)	\$ 2,964.39	\$ 6,126.44	\$ 849.24

STATEMENT OF ACCOUNT

In re: Faye Clark, 304 Marguerite, Corona Del Mar, California.

Docket No. 48543

Income Tax — Year 1945

	Tax	50% Fraud Penalty	Interest
Paid:			
May 31, 1946	\$ 271.36	None	None
Paid on joint estimated tax:			
March 15, 1945 \$ 250.00			
June 15, 1945 .. 250.00			
Sept. 15, 1945 .. 950.00			
Jan. 15, 1946 .. 250.00			
Total	1,700.00		
Faye Clark's one-half	850.00	None	None
January 18, 1954	370.80	None	None
Totals paid	\$1,492.16	None	None
Liability	1,121.36	None	None
Overpayment (Section 322(d) (1)(D) of the 1939 Internal Revenue Code)	\$ 370.80	None	None

Return filed March 15, 1946.

Deficiency notice dated February 20, 1953.

Claim for refund filed September 20, 1955.

Year 1946

	Tax	50% Fraud Penalty	Interest
Paid:			
March 15, 1947	\$ 2,037.50	None	None
Paid on estimated tax:			
March 15, 1946 \$230.38			
June 17, 1946 .. 230.38			
Sept. 16, 1946 .. 230.38			
Jan. 17, 1947 .. 230.36	921.50	None	None
Tax withheld by employer ..	945.70	None	None
January 18, 1954	5,470.80	None	None
Totals paid	\$ 9,375.50	None	None
Liability	3,904.70	None	None

Overpayment (Section 322(d)

(1) (D) of the 1939 Internal

Revenue Code) \$ 5,470.80 None None

Return filed March 15, 1947.

Deficiency notice dated February 20, 1953.

Claim filed for refund September 20, 1955.

Year 1947

Paid:			
March 15, 1948	\$ 485.34	None	None
Tax withheld by employer	1,418.82	None	None
January 18, 1954	5,513.79	None	None
Totals paid	\$ 7,417.95	None	None
Liability	11,192.64	None	2,660.95
Deficiency in payment	\$ 3,774.69	None	\$2,660.95

[Endorsed]: T.C.U.S. Filed November 13, 1957.

Tax Court of the United States
Washington

Docket No. 48542

GENE O. CLARK,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion filed July 17, 1957, the parties on November 13, 1957, having filed an agreed computation of the tax, it is

Ordered and Decided: That there is an overpayment in income tax for the taxable year 1945 in the amount of \$361.75, which amount was paid after the mailing of the notice of deficiency, and that there is no addition to tax under section 293(b), I.R.C. 1939, for the taxable year 1945; and, without considering the jeopardy assessment made prior to the issuance of the notice of deficiency and payments made pursuant thereto, there are deficiencies in income tax and additions to tax under section 293(b), I.R.C. 1939, for the taxable year 1946 in the respective amounts of \$11,752.35 and \$5,876.18, and for the taxable year 1947 in the respective amounts of \$9,141.45 and \$4,570.73.

Entered November 20, 1957.

[Seal] /s/ MORTON P. FISHER,
Judge.

Served and Entered November 21, 1957.

Tax Court of the United States
Washington

Docket No. 48543

FAYE CLARK, Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion filed July 17, 1957, the parties on November 13, 1957, having filed an agreed computation of the tax, it is

Ordered and Decided: That there are overpayments in income tax for the taxable years 1945 and 1946 in the respective amounts of \$370.80 and \$5,470.80, which amounts were paid after mailing the notice of deficiency, and that there are no additions to tax under section 293(b), I.R.C. 1939, for the taxable years 1945 and 1946; and, without considering the jeopardy assessment made prior to the issuance of the notice of deficiency and payments made pursuant thereto, there is a deficiency in income tax for the taxable year 1947 in the amount of \$9,288.48 and there is no addition to tax under section 293(b), I.R.C. 1939, for the taxable year 1947.

Entered November 20, 1957.

[Seal] /s/ MORTON P. FISHER,
Judge.

Served and Entered November 21, 1957.

[Title of Court of Appeals and Tax Docket No. 48542.]

PETITION FOR REVIEW

Gene O. Clark, the petitioner in this cause, by Alva C. Baird and Thomas A. Baird, his counsel, hereby files his petition for a review by the United States Court of Appeals for the Ninth Circuit, of the decision of the Tax Court of the United States on November 20, 1957, pursuant to its Findings of Fact and Opinion promulgated on July 17, 1957 (T.C. Memo 1957-129) ordering and deciding:

“* * * without considering the jeopardy assessment made prior to the issuance of the notice of deficiency and payments made pursuant thereto, there are deficiencies in income tax and additions to tax under section 293(b), I.R.C. 1939, for the taxable year 1946 in the respective amounts of \$11,752.35 and \$5,876.18, and for the taxable year 1947 in the respective amounts of \$9,141.45 and \$4,570.73.”

I.

Jurisdiction

The petitioner, Gene O. Clark, and Faye Clark were husband and wife during the calendar years 1946 and 1947, inclusive, and resided in Los Angeles County, California. All income derived by petitioner during the years 1946 and 1947, inclusive, was community income. For the calendar years 1946 and 1947, petitioner filed separate income tax returns on the community property basis with the Collector of Internal Revenue for the Sixth District

of California (now the Director of Internal Revenue, Sixth Collection District) whose office is located at Los Angeles, California, which collection district is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

II.

Nature of Controversy

This controversy involves the proper determination of the petitioner's liability for Federal income taxes for the taxable years 1946 to 1947, inclusive.

Prior to May 1, 1946, petitioner Gene O. Clark and one Archie M. Koyl were engaged in a joint venture doing business under the firm name and style of Gene Clark Plumbing Co. This business consisted of two shops located in El Monte and Bell Gardens, California. The primary business of the Gene Clark Plumbing Co. was the selling of plumbing supplies and rendering plumbing services to building contractors.

On April 23, 1946, petitioner and the said Archie M. Koyl organized a California corporation, Gene O. Clark, Inc., to engage in the wholesale plumbing business. Said corporation actively began business on May 1, 1946. Petitioner Gene O. Clark owned 70% of the outstanding stock of the corporation, and Archie M. Koyl owned 30% of the stock during the period here involved. Gene O. Clark was president of the corporation and Archie M. Koyl was vice president thereof. The corporation occupied

the same premises as the predecessor joint venture, Gene Clark Plumbing Co.

Gene Clark, Inc. kept its books on the accrual method and reported its income on a fiscal year basis beginning with the year ending April 30, 1947.

During each of the years 1946 and 1947, the Commissioner contended that petitioner received monies and property from sales made by the corporation, which were not recorded on its books nor reported in the tax returns of the corporation or the petitioner.

Through the use of an arbitrary formula, the Commissioner determined that petitioner received constructive dividends from Gene Clark, Inc. and added such alleged constructive dividends to petitioner's income for each of the years involved. The Commissioner also contended that there was an omission from gross income in the returns of the petitioner for each of the years 1946 and 1947 of amounts properly includible therein, which were in excess of twenty-five percentum of the amount of gross income stated in said returns, and that each of the returns of the petitioner for the years 1946 and 1947 were false and fraudulent with intent to evade taxes, and further that a part of the deficiency of the petitioner for each of the years 1946 and 1947 was due to fraud with intent to evade taxes.

III.

Statement of Points

The petitioner intends to rely upon the following points in this proceeding:

That the Tax Court of the United States erred:

(1) In holding and finding that petitioner Gene O. Clark was the president and majority stockholder of Gene Clark, Inc. from April 23, 1946 to March 1, 1949, inclusive, and as such was the dominating factor in conducting and controlling its corporate affairs.

(2) In holding and finding that Gene Clark, Inc. received substantial amounts of taxable income from unrecorded sales which it failed to report on its returns.

(3) In holding and finding that petitioner withheld and diverted to his own purposes substantial amounts of the proceeds of the alleged unreported sales.

(4) In holding and finding that petitioner realized unreported income from informal or constructive dividends from Gene Clark, Inc. for the calendar years 1946 and 1947 which he failed to report on his individual tax returns for the years 1946 and 1947.

(5) In holding and finding that the assessment and collection as to petitioner was not barred by the Statute of Limitations as to the years 1946 and 1947.

(6) In holding and finding that each of the returns of the petitioner for the years 1946 and 1947 was false and fraudulent with intent to evade taxes.

(7) In holding and finding that a part of the deficiency of petitioner for each of the years 1946 and 1947 was due to fraud with intent to evade taxes.

(8) In holding and finding that petitioner did not sustain his burden of proof for each of the taxable years 1946 and 1947.

IV.

The petitioner, Gene O. Clark, being aggrieved by the findings of fact and conclusions of law contained in the said findings and opinion of the Court, and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

/s/ THOMAS A. BAIRD,

Counsel for Petitioner.

Of Counsel: Alva C. Baird, Gerald A. Sheppard,
Albert J. Galen.

Duly Verified.

[Endorsed]: T.C.U.S. Filed February 10, 1958.

[Title of Court of Appeals and Tax Docket No.
48543.]

PETITION FOR REVIEW

Faye Clark, the petitioner in this cause, by Alva C. Baird and Thomas A. Baird, her counsel, hereby files her petition for a review by the United States Court of Appeals for the Ninth Circuit, of

the decision of the Tax Court of the United States on November 20, 1957, pursuant to its Findings of Fact and Opinion promulgated on July 17, 1957 (T.C. Memo 1957-129) ordering and deciding:

“* * * without considering the jeopardy assessment made prior to the issuance of the notice of deficiency and payments made pursuant thereto, there is a deficiency in income tax for the taxable year 1947 in the amount of \$9,288.48 * * *.”

I.

Jurisdiction

The petitioner, Faye Clark, and Gene O. Clark were husband and wife during the calendar year 1947, and resided in Los Angeles County, California. All income derived by petitioner during the year 1947, was community income. For the calendar year 1947, petitioner filed a separate income tax return on the community property basis with the Collector of Internal Revenue for the Sixth District of California (now the Director of Internal Revenue, Sixth Collection District) whose office is located at Los Angeles, California, which collection district is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

II.

Nature of Controversy

This controversy involves the proper determination of the petitioner's liability for Federal income taxes for the taxable year 1947.

Prior to May 1, 1946, petitioner's husband, Gene O. Clark, and one Archie M. Koyl were engaged in a joint venture doing business under the firm name and style of Gene Clark Plumbing Co. This business consisted of two shops located in El Monte and Bell Gardens, California. The primary business of the Gene Clark Plumbing Co. was the selling of plumbing supplies and rendering plumbing services to building contractors.

On April 23, 1946, Gene O. Clark and the said Archie M. Koyl organized a California corporation, Gene O. Clark, Inc., to engage in the wholesale plumbing business. Said corporation actively began business on May 1, 1946. Gene O. Clark owned 70% of the outstanding stock of the corporation, and Archie M. Koyl owned 30% of the stock during the period here involved. Gene O. Clark was president of the corporation and Archie M. Koyle was vice president thereof. The corporation occupied the same premises as the predecessor joint venture, Gene Clark Plumbing Co.

Gene Clark, Inc. kept its books on the accrual method and reported its income on a fiscal year basis beginning with the year ending April 30, 1947.

During each of the years 1946 and 1947, the Commissioner contended that petitioner's husband, Gene O. Clark, received monies and property from sales made by the corporation, which were not recorded on its books nor reported in the tax returns of the corporation, or the petitioner, or her husband, Gene O. Clark.

Through the use of an arbitrary formula, the Commissioner determined that petitioner and her husband received constructive dividends from Gene Clark, Inc. and added one-half of such alleged constructive dividends to petitioner's income for each of the years involved. The Commissioner also contended that there was an omission from gross income in the return of the petitioner for the year 1947 of amounts properly includible therein, which were in excess of twenty-five percentum of the amount of gross income stated in said return.

III.

Statement of Points

The petitioner intends to rely upon the following points in this proceeding:

That the Tax Court of the United States erred:

(1) In holding and finding that petitioner's husband, Gene O. Clark, was the president and majority stockholder of Gene Clark, Inc. from April 23, 1946 to March 1, 1949, inclusive, and as such was the dominating factor in conducting and controlling its corporate affairs.

(2) In holding and finding that Gene Clark, Inc. received substantial amounts of taxable income from unrecorded sales which it failed to report on its returns.

(3) In holding and finding that petitioner and her husband, Gene O. Clark, withheld and diverted to their own purposes substantial amounts of the proceeds of the alleged unreported sales.

(4) In holding and finding that petitioner and her husband, Gene O. Clark, realized unreported income from informal or constructive dividends from Gene Clark, Inc. for the calendar year 1947 which they failed to report on their individual tax return for the year 1947.

(5) In holding and finding that the assessment and collection as to petitioner was not barred by the Statute of Limitations as to the year 1947.

(6) In holding and finding that petitioner did not sustain her burden of proof for the taxable year 1947.

IV.

The petitioner, Faye Clark, being aggrieved by the findings of fact and conclusions of law contained in the said findings and opinion of the Court, and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

/s/ THOMAS A. BAIRD,

Counsel for Petitioner.

Of Counsel: Alva C. Baird, Albert J. Galen,
Gerald A. Sheppard.

Duly Verified.

[Endorsed] T.C.U.S. Filed February 10, 1958.

[Title of Court of Appeals and Tax Docket No. 48542.]

NOTICE OF FILING PETITION
FOR REVIEW

To: Nelson P. Rose, Chief Counsel, Internal Revenue Service, Washington, D. C.

You are hereby notified that the petitioner on the 7th day of February, 1958, filed with the Clerk of The Tax Court of The United States at Washington, D.C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States heretofore rendered in the above-entitled cause. A copy of the Petition for Review and the assignments of error as filed is hereto attached and served upon you.

Dated at Los Angeles, California, this 7th day of February, 1958.

Respectfully,

/s/ THOMAS A. BAIRD,
Counsel for Petitioner.

Acknowledgment of Service Attached.

[Endorsed]: T.C.U.S. Filed February 17, 1958.

[Note: Notice of Filing Petition for Review in Docket No. 48543 is the same as in Docket No. 48542.]

[Title of Tax Court and Docket Nos. 48542-3.]

ORDER ENLARGING TIME

For cause, it is

Ordered: That the time for filing the record on review and docketing the petitions for review in the United States Court of Appeals for the Ninth Circuit is extended to May 11, 1958.

Dated: Washington, D. C., March 3, 1958.

[Seal] /s/ J. E. MURDOCK,
 Judge.

Served March 3, 1958.

The Tax Court of the United States

Docket Nos. 48542, 48543, 48544

GENE O. CLARK, FAYE CLARK, GENE O.
CLARK and FAYE CLARK, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STIPULATION OF FACTS

The parties hereto, through their respective counsel hereby stipulate and agree to the facts hereinafter set forth:

1. That the income tax returns of the Petitioners for the taxable years 1945 to 1949 inclusive, were prepared and filed on the cash basis and for

a calendar year accounting period. All income tax returns of the Petitioners for said period 1945 to 1949 inclusive were filed on the 15th day of March following the close of the calendar year. No agreements extending the statute of limitations on assessment or collection were entered into between the Petitioners and the Respondent for the taxable year 1945, 1946 or 1947. An agreement extending the statute of limitations was executed by the parties for the calendar year 1948. With reference to the taxable years 1948 and 1949 the statute of limitations is not an issue.

2. That on or about December 24, 1952, the Respondent made jeopardy assessments against the Petitioners herein, for the deficiencies and penalties as set forth in the statutory notices of deficiency.

3. That on or about January 14, 1954, the Petitioners forwarded their cashier's check in the amount of \$34,670.81 to the Director of Internal Revenue at Wichita, Kansas, together with instructions to apply same against said jeopardy assessment. The Director received said check and credited said assessment as follows:

Year	Gene Clark	Faye Clark	Gene O. Clark and Faye Clark
1945	\$ 361.75	\$ 370.80	
1946	5,423.91	5,470.80	
1947	5,444.42	5,513.79	
1948			\$8,901.26
1949			3,147.96

4. That Gene Clark, Inc., a California corporation, was organized on May 1, 1946 as successor

to Gene Clark Plumbing Company. There were authorized and issued 522 shares of stock. These shares of stock were issued in the following manner:

364 shares to Gene O. Clark

157 shares to Archie M. Koyl

On or about March 31, 1948, Gene O. Clark purchased 157 shares of stock owned by Archie M. Koyl, and at that time owned 100% of the stock. On or about March 1, 1949, Archie M. Koyl purchased 262 shares and Fawn A. Koyl purchased 260 shares, making a total of 522 shares, of the stock of Gene Clark, Inc., a corporation, from Gene O. Clark.

5. That on or about May 1, 1946, Gene O. Clark acquired 364 shares of common stock in Gene Clark, Inc., at a cost of \$36,500.00; and that on or about March 31, 1948, Gene O. Clark purchased 157 shares of common stock in Gene Clark, Inc., at a cost of \$24,714.49; and that the total cost of the 521 shares was \$61,214.49.

6. That the Petitioners sustained a loss on farm operations in the taxable year 1948 in the amount of \$17,233.05, and that said loss shall be allowed in any recomputation of tax liability for said year.

7. That the Petitioners sustained a loss on farm operations in the taxable year 1949 in the amount of \$17,060.52, and that said loss shall be allowed in any recomputation of tax liability for said year.

8. That the Petitioners sustained a net operating loss in 1950 in the amount of \$4,513.62, which amount is properly allowable as a loss carryback

to the year 1949. Said loss carryback shall be allowed in any recomputation of deficiencies for the taxable year 1949.

Respectfully submitted.

/s/ ALVA C. BAIRD,

Counsel for Petitioners.

Of Counsel: Thomas A. Baird, Frank W. Mahoney.

/s/ R. P. HERTZOG, ECC.,

Acting Chief Counsel, Internal Revenue Service,
Counsel for Respondent.

[Endorsed]: T.C.U.S. Filed March 30, 1955.

[Title of Tax Court and Dockets Nos. 48542-3.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 61, inclusive, constitute and are all of the original papers as called for by the "Designation of Contents of Record on Review" (but excluding the exhibits which are separately certified) on file in my office as the original and complete record in the cases before the Tax Court of the United States docketed at the above numbers and in which the petitioners in the Tax Court have filed petitions for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court cases, as the same appear in the official docket in my office.

In testimony whereof, I hereunto set my hand

and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 4th day of March, 1958.

[Seal] /s/ HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

[Title of Tax Court and Docket Nos. 48542-3.]

STIPULATION

It is hereby stipulated by and between counsel for the respective parties that the testimony of Revenue Agent Donald E. Phillips in the cases of Archie M. Koyl, et al., v. Commissioner of Internal Revenue, T. C. Docket Nos. 48336, 48337 and 48338, on March 29 and 30, 1955, pages 156 to 269, inclusive of the transcript of testimony in said cases, shall be certified and transmitted by the Clerk of the Tax Court of the United States to the Clerk of the United States Court of Appeals for the Ninth Circuit as part of the Record on Review in this proceeding.

Dated: May 26, 1958.

/s/ THOMAS A. BAIRD,
Counsel for Petitioner.

/s/ ARCH M. CANTRALL,
Chief Counsel, Internal Revenue Service, Counsel
for Respondent.

[Endorsed]: T.C.U.S. Filed May 29, 1958.

[Title of Tax Court and Docket Nos. 48542-3.]

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the foregoing original documents numbered 62 and 63, on file in my office, constitute (1) pages 156 to 269, inclusive, of the transcript of the trial in the cases of Archie M. Koyl, et al., T. C. Docket Nos. 48366, 48337, and 48338, said pages containing the testimony of Donald E. Phillips, and which testimony was incorporated as evidence in the record in the above-entitled cases, so far as relevant; and (2) stipulation for supplemental record, which original documents constitute a supplemental record on this review, pursuant to said stipulation.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 2nd day of June, 1958.

[Seal] /s/ HOWARD P. LOCKE,
Clerk, Tax Court of the
United States.

In The Tax Court of the United States

Docket No. 48542

Gene O. Clark, Petitioner, vs. Commissioner of
Internal Revenue, Respondent.

Docket No. 48543

Faye Clark, Petitioner, vs. Commissioner of In-
ternal Revenue, Respondent.

Docket No. 48544

Gene O. Clark and Faye Clark, Petitioners, vs.
Commissioner of Internal Revenue, Respond-
ent.

TRANSCRIPT OF PROCEEDINGS

Courtroom No. 9, U. S. Post Office, Los Angeles,
California, Wednesday, March 30, 1955.

The above-entitled matter came on for hearing,
pursuant to notice to the parties, at 12:10 o'clock
p.m. [1]*

Before: Honorable Morton P. Fisher, Judge Pre-
siding.

Appearances: Alva C. Baird, Esq., and Thomas
A. Baird, Esq., 458 South Spring Street, Los Ange-
les 13, California, for the Petitioners. Sidney J.
Machtinger, Esq., and J. Earl Gardner, Esq. (Hon.

* Page numbers appearing at top of page of Reporter's Tran-
script of Record.

Daniel A. Taylor, Chief Counsel, Internal Revenue Service), for the Respondent. [2]

* * * * *

PARIS B. CLAYPOOLE

was called as a witness by and on behalf of the petitioners, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Paris, P-a-r-i-s, B., Claypoole, [23] C-l-a-y-p-o-o-l-e, 619 East Foothill, Altadena, California.

Q. (By Mr. T. Baird): Mr. Claypoole, will you state your present occupation?

A. I am an accountant licensed to practice in California.

Q. Public accountant? A. Yes.

Q. Will you tell the Court a little of your background? Where did you go to school?

A. I attended public schools of Cincinnati, Ohio and the University of Cincinnati for about two years immediately preceding World War I.

Q. Then what happened? What did you do after that?

A. After leaving military service at the beginning of 1919, I was assigned to the War Department Ordnance Section for accounting duties for approximately six months until I was appointed traveling auditor for the Bureau of Internal Revenue and for some two years I was a traveling

(Testimony of Paris B. Claypoole.)

auditor and, thereafter, an Internal Revenue agent until December 31st, 1953, when I retired.

Q. What did you do with the Bureau of Internal Revenue, Mr. Claypoole?

A. My duties in the Bureau consisted of the examination of income tax returns of all classifications, principally corporations and individuals and, specifically, for about 25 years I was either engaged in or supervised the examinations of cases [24] in which fraud was alleged by the Government.

* * * * *

Q. Mr. Claypoole, I show you a schedule which is entitled "Gene Clark, Inc., Fiscal Year April 30, 1947, Analysis of Income Available for Distribution to Stockholders for Fiscal Year Ended April 30, 1947, Based on Report of Revenue Agent D. E. Phillips (February 4, 1953)—Said Report Being the Basis of the 90-Day Letter." Did you prepare this schedule, Mr. Claypoole? A. I did.

Q. And what did you prepare the schedule from?

A. I prepared that from the Revenue Agent's report, the income tax return of the corporation for the fiscal year ended 4/30/1947 and related that to the returns of the individuals, [25] Gene and Faye Clark.

Q. In other words, this is an analysis of Mr. Phillips' computations? A. Entirely so.

Mr. T. Baird: I would like to have this marked as petitioners' exhibit next in order.

(Testimony of Paris B. Claypoole.)

The Clerk: Petitioners' Exhibit 15 marked for identification.

* * * * *

Q. (By Mr. T. Baird): Mr. Claypoole, the first item that we come to on this schedule is Income Per Tax Return. Where did you get the amount of \$30,632.10? Where did you get that figure from?

A. That figure is taken from two places, first, the income, the net income reported by the corporation on its tax return for the fiscal year April 30, 1947, and also from Schedule 1, page 5 of Revenue Agent Phillips' report on the corporation.

Q. In other words, does that figure reflect the income that was reported on the tax return of the corporation? A. It does. [26]

Q. The next item we come to is Add Adjustments to Taxable Income in the amount of \$102,050.17. Where did you get this figure from, Mr. Claypoole?

A. That figure came from the Schedule 1, page 5, of the Internal Revenue Agent's report on the corporation.

Q. Was that figure also reflected in Schedule Q of said report, Mr. Claypoole? A. Yes, sir.

Q. The next item we come to is Net Income Per RAR, \$132,682.27. Is that the net income that Revenue Agent Phillips arrived at for the fiscal year April 30, 1947, Mr. Claypoole?

A. Yes, it is.

Q. And where did you find that figure in his report?

(Testimony of Paris B. Claypoole.)

A. That figure appears in Schedule 1, page 5, of the Revenue Agent's report.

Q. I notice the next item is Less: Income Not Available for Distribution Per Books, Tax Return and RAR, in the Amount of \$30,632.10. Can you explain, Mr. Claypoole, why that is not available for distribution per the books, tax returns and RAR and where did you get the figure, if I may ask a compound question?

A. The \$30,000 is the net income reported by the corporation for its fiscal year April 30, 1947. It is the net result as reflected in the balance sheet of the corporation with [27] the tax return which in turn discloses how and what the corporation did with the \$30,000.

Q. And I see that you have subtracted that from the net income and arrived at a figure of \$102,050.17—

* * * * *

Q. (By Mr. T. Baird): Where does that figure, \$102,050.17 show in the Revenue Agent's report, Mr. Claypoole?

A. That figure is taken from Exhibit Q, page 81 of the Revenue Agent's report.

Q. Do you have a copy of the Revenue Agent's report with you? A. Yes, sir.

Q. Will you show that figure to His Honor and where you are looking on Schedule Q? Will you let the Judge keep that for a while, Mr. Claypoole?

The Court: Go ahead.

Mr. T. Baird: Thank you.

(Testimony of Paris B. Claypoole.)

Q. (By Mr. T. Baird): The next items that we come to you have identified as Items Not Available for Distribution Per Exhibit Q and you have a list of items listed in your schedule, the first one of which [28] is Truman Johnson deal, \$6,000. Is that reflected in Schedule Q, Mr. Claypoole?

A. That is reflected in Schedule Q as part of a total of \$63,488.47. It is broken down in Exhibit Q-1, page 83, which is the explanation of the \$63,000 item.

* * * * *

Q. (By Mr. T. Baird): Are all of the rest of the items, the H. L. Brittian transaction in the amount of \$1,860.40, the deferred income item of \$49,210.15, the merchandise account in the amount of \$2,714.42, bad debts in the amount of \$3,703.50, are these also reflected and make up the figure \$63,488.47, Mr. Claypoole? A. They do.

Q. And was this figure entitled by Revenue Agent Phillips in Schedule Q as Adjustments to Net Income Not Available? A. It was.

Q. And where else in the report is there a subtitle to Schedule Q, Mr. Claypoole? Is there a Q-1, for instance?

A. Yes, Exhibit Q-1, page 83, is the explanation sheet for Exhibit Q, page 82 and 82.

Q. And are all the items listed on your schedule that I have just mentioned listed in Q-1 of the Revenue Agent's [29] report?

A. They are.

Q. As not being available for distribution?

(Testimony of Paris B. Claypoole.)

A. Yes, sir.

Q. I see that you have subtracted these Items Not Available for Distribution Per RAR from the \$102,000 and arrive at a figure of \$38,561.70. Then I see that you have—what is the next step that you took after that, Mr. Claypoole?

A. The next step is to apply that figure, the amount of income tax set-up in the Revenue Agent's report as the income tax applying to the \$132,682.27. That is found on page 19 of the Revenue Agent's report.

* * * * *

Q. Was the amount \$38,561.70 under your heading Items [30] Not Available for Distribution Per Exhibit Q and under Mr. Phillips' Item B of Schedule Q, Adjustments to Net Income Not Available, were those items taken into consideration in the deficiency notice?

Mr. Machtinger: Objection, I object to the use of the word "taken into consideration". Does he mean by the agent or whether they were computed on the return of just what is the meaning of the term "taken into consideration"?

Q. (By Mr. T. Baird): Were these accounting adjustments taken into consideration in the 90-day letter as well as upon Schedule Q from your analysis? A. These—

Mr. Machtinger: Are you asking his opinion?

Mr. T. Baird: I am asking what he found from his analysis.

The Court: Well, I don't quite get what you are

(Testimony of Paris B. Claypoole.)

referring to. The stipulation is that for the purpose of determining the basis of calculations, the Revenue Agent's report is admitted in evidence and that the Revenue Agent's report is the basis for the statutory notice of deficiency.

Mr. T. Baird: That is correct, your Honor.

The Court: Now, are you directing this witness' attention to some element in which the statutory notice of deficiency differs from the Revenue Agent's report or what? [31]

Mr. T. Baird: I am, your Honor.

The Court: You are?

Mr. T. Baird: I am.

The Court: All right, let's make it clear so he's got it before him. Let's see what it means.

Q. (By Mr. T. Baird): From your analysis, Mr. Claypoole, I will ask again, did you find that these items were taken into consideration in the deficiency notice?

A. They were not as such considered as—well, strike that. They were treated as available for distribution in the statutory notice.

Q. But were they adjusted and deducted from that amount available for distribution?

A. No, sir.

Mr. Machtinger: Excuse me, could you please identify the word "they"? 'I have lost—

Mr. T. Baird: Well, we have been referring to the items not available for distribution per Exhibit

Q. I have also referred to it in Exhibit Q as Item D, adjustments to net income, in the amount of

(Testimony of Paris B. Claypoole.)

\$63,000. I also refer you to Schedule Q-1 where you find the same figures.

Q. (By Mr. T. Baird): And the amount of Federal income tax per RAR in the amount of \$50,419.26, from your analysis, Mr. Claypoole, can [32] you state whether or not this item was taken into consideration as a deduction before arriving at the figure Net Income Available for Distribution? A. In part.

Q. In the deficiency notice? A. In part.

Q. In part. And what part? Have you a breakdown on that?

A. Yes, sir. In the Revenue Agent's report, he used an item of \$43,885.88 as reduction surplus available for distribution, whereas in his report he shows the tax at \$50,419.26.

Q. Well, now, Mr. Claypoole, this may be repetitious, but where in the report does he show \$50,419.26 as a proper deduction?

A. On page 19 of the Revenue Agent's report.

Q. Does he show anywhere in the Revenue Agent's report a deduction of \$43,000 some-odd dollars? A. Yes, he does.

Q. —\$885.88. Where does he show that in the report, Mr. Claypoole?

A. He shows that on page 19 and also on the statement of tax liability as deficiency tax.

Q. Well, have you been able to reconcile these two figures or arrive at any accounting method of the difference of why in one instance \$50,419.26 was subtracted from available [33] net income and

(Testimony of Paris B. Claypoole.)

on the other hand in another portion of his report only \$43,885.85 was deducted from available net income? A. Yes, I have.

Q. What is that, Mr. Claypoole?

A. The difference between the \$43,885.85 and \$50,419.26 is \$6,533.38. On the original tax return filed or on the tax return filed by the corporation, the tax was determined as \$8,735.01. In 1950, the examination of the tax return was made by a Revenue Agent resulting in a refund to the corporation on its 1947 return of \$2,201.63. The difference between what they paid originally and the amount refunded makes the \$6,533.38 difference between these figures as I have indicated.

Q. In other words, from your analysis, Mr. Claypoole, the agent did not take into consideration the tax already paid?

Mr. Machtinger: Objection. I don't see that this witness can testify as to what the agent did not take into account. He might testify as to any differences between the agent's report and his own report.

Mr. T. Baird: I am asking from his analysis, your Honor.

The Court: Well, this witness is making a calculation based on a calculation. So far as I have been able to see, his calculation is based on a calculation that everybody agrees is wrong and has agreed was wrong right straight through. Then the parties stipulate that the Revenue Agent's report is [34] the basis for the 90-day letter and then

(Testimony of Paris B. Claypoole.)

this witness says that the one isn't based on the other in some respects. Then he points out that somewhere in the Revenue Agent's report which is admitted not for the purpose of the facts but for the purpose of the calculation, there is something to the effect that certain items are not available for distribution.

Then he testifies that the paramount determination which is the statutory notice of deficiency doesn't hold that these items are not to be taken into account. Now, where we are at this moment, I don't know. I assume it would be unraveled, but this far all I can see is a calculation which may later prove to be of interest.

Mr. T. Baird: May I continue?

The Court: Yes, indeed.

Q. (By Mr. T. Baird): Mr. Claypoole, the next item on your schedule, Exhibit 15, is Income Available for Distribution—Nothing. What figure have you arrived at as available for distribution by the corporation, Gene Clark, Inc.?

A. This calculation shows nothing available but, in fact, a deficit of \$11,857.56.

Q. The next item you have is Total Distribution Per RAR, and what does that show?

A. That shows in Exhibit Q, page 81, that the Revenue Agent determined \$74,984.76 available for distribution. [35]

Q. In summary, Mr. Claypoole, how did you arrive at the deficit of \$11,857.56 whereas the Rev-

(Testimony of Paris B. Claypoole.)

Revenue Agent arrived at an amount available for distribution of \$74,984.76?

A. He did not relate Exhibit Q to the surplus account of the corporation.

Q. Where is that surplus account in the report?

A. The surplus account is Exhibit D, page 58 of the Revenue Agent's report.

Q. Looking down, now, at your schedule, I see you have here Constructive Dividend to Gene and Faye Clark Per 90-Day Letters and a breakdown of what was determined by the Revenue Agent to be distributed to Gene Clark and Faye Clark in the calendar years 1946 and 1947. Where did you get those figures, Mr. Claypoole?

A. Those figures came from the Revenue Agent's reports on Gene and Faye Clark and from the statutory notice of deficiencies.

Q. Now I see over in the far right-hand column a total of these two years in the amount of \$91,728.12. Did you get that figure from the same place?

A. That is just the total of these, the \$91,000 does not appear as such in either report but is just a total of the amounts appearing in the two reports, in the statutory notices.

Q. Mr. Claypoole, it is obvious from your schedule that there is a difference in the Revenue Agent's report of the [36] amount available for distribution and that as is shown in the 90-day letter. Just so the record may show, will you state, have

(Testimony of Paris B. Claypoole.)

you arrived at the difference between those two figures? A. Yes, sir.

Q. What is that difference, Mr. Claypoole? In other words, I mean mathematically, what difference? Do you have that figure before you?

A. No, I haven't made that calculation.

Q. Do not take the time. Just state what the distribution per RAR shows as available for distribution. A. \$74,984.96

Q. And what does the statutory notice of deficiency show?

A. The total is \$91,728.12.

Q. Have you tried to through accounting methods to reconcile the differences between these two figures?

A. Well, I know wherein the differences arose, what created the differences.

Q. And what were those determinations, Mr. Claypoole?

Mr. Machtinger: Mr. Baird, will you ask the witness to point out where the \$91,000 figure is on the notice of deficiency?

The Court: Well, I assume it must be an accumulation of a number of figures. You have got two taxpayers and two different years involved.

* * * * * [37]

Q. (By Mr. T. Baird): Do you know what the question is, Mr. Claypoole?

A. Yes, sir. In the Revenue Agent's report, in the surplus account, he used \$132,682.27 as the correct taxable net income. He reduced that by

(Testimony of Paris B. Claypoole.)

income taxes of \$43,885.88 and another item of \$2,714.42.

Q. Mr. Claypoole, may I interrupt you for a moment? Would it be easier for you to testify if we went to the next schedule?

A. Well, I am using the next schedule, sir.

Q. I know, that is why I asked.

Mr. Claypoole, I show you a schedule entitled "Gene Clark, Inc., Fiscal Year April 30, 1947," with the heading "Comparative Analysis of Surplus for Year Ended April 30, 1947, Based Upon Report of Examination by Revenue Agent Don E. Phillips and 90-Day Letter Showing Amount Available for Distribution as a Constructive Dividend." Did you prepare this schedule, Mr. [38] Claypoole?

A. Yes, sir.

Q. Where did you get the figures that are in that schedule?

A. From the Revenue Agent's report and tax return and the 90-day letters.

Mr. T. Baird: I would like, first of all, to enter Exhibit 15 into evidence as Petitioners' Exhibit No. 15.

Mr. Machtinger: We have no objection to it being offered in evidence, your Honor.

The Clerk: Petitioners' Exhibit No. 15 admitted in evidence.

(Petitioners' Exhibit No. 15 was received in evidence.)

Mr. T. Baird: I would now like this comparative analysis, the last schedule, marked for identification.

(Testimony of Paris B. Claypoole.)

The Clerk: Petitioners' Exhibit 16 marked for identification.

(Petitioners' Exhibit No. 16 was marked for identification.)

Mr. T. Baird: Do you have a copy, counsel, of this?

Mr. Machtinger: I have a copy of 15.

Mr. T. Baird: I gave you two.

Q. (By Mr. T. Baird): Now, Mr. Claypoole, referring to the last question, [39] I believe that all involved will be able to follow your answers to that last question of how the difference between what was stated as the amount available for distribution on the 90-day letter and that available for distribution in the Revenue Agent's report differs. What items did you observe from your analysis of the Revenue Agent's report? What did you observe was taken into consideration by Revenue Agent Phillips in arriving at his figure?

A. In this surplus analysis, only two items were considered after the use of the corrected taxable net income of \$132,682.27. They deducted income taxes and an item called Merchandise Purchases, \$2,714.42.

Q. Did he also—I see from your schedule he deducted certain dividends, I assume constructive dividends set up by the agent.

A. Those figures shown as Gene Clark, \$52,-489.47, came from Exhibit Q. The one for Archie Koyl, \$22,495.49, came from Exhibit Q.

Q. Just for the record, when we refer to Exhibit

(Testimony of Paris B. Claypoole.)

Q, do you mean of the Revenue Agent's report?

A. Yes, sir.

Q. Now, looking across down at the item Merchandise Purchases, wherein in the report does that show up besides Exhibit Q?

A. That is in Exhibit D, a surplus charge. [40]

Q. At what page? A. 58.

Q. Now, looking at the Truman Johnson transaction, is that also shown on Exhibit D, page 58 of the Revenue Agent's report? A. No, sir.

Q. Is it shown as a proper deduction from surplus elsewhere in his report?

A. In Exhibit Q.

Q. And at any place in the report of an explanation of Exhibit Q?

A. Exhibit Q-1, page 83.

Q. And the other items, H. L. Brittian transaction, deferred income, and bad debt adjustment, are those also taken into consideration by Revenue Agent Phillips on Exhibit Q and explanatory Q-1?

A. Yes, sir.

Q. Are they taken into consideration by Mr. Phillips in his surplus exhibit on page 58?

A. No, sir.

Q. Of his report. From an accounting sense, Mr. Claypoole, can you see any reason why these items should have been taken into consideration in arriving at the distributable net income?

A. They were items determined to not be available for [41] distribution in this year ended April 30, 1947.

(Testimony of Paris B. Claypoole.)

Q. Well, what I am getting at is would you as an accountant consider the item Truman Johnson transaction not available for distribution? Are you familiar with that transaction, Mr. Claypoole?

A. Yes, sir.

Q. Would you consider the \$6,000 as represented by that transaction available for distribution?

A. No, sir, it is not available for distribution.

Q. Why?

A. Because it was stated to represent an investment in real estate which the corporation owned. It was a corporate asset the way it was treated in the Revenue Agent's report.

Q. Well, isn't it possible to distribute a house?

A. Well, it was not distributed in the year 4/30/47.

Q. And what is, to your knowledge, the H. L. Brittian transaction?

A. That is an account receivable, the details of which I am not familiar with.

Q. And then, to your knowledge, the deferred income item?

A. That is an accounting adjustment which was deferred income.

Q. What do you mean by deferred income? What does the Revenue Agent Phillips mean by deferred income in this particular case? [42]

A. In this case, it was income collected on work to be performed or partially completed, work which had not been completed in the year ended April 30, 1947.

Q. How was that item carried on the books and

(Testimony of Paris B. Claypoole.)

records of Gene Clark, Inc. as you have seen the records or the corporation tax return?

A. As a liability.

Q. Would you, as an accountant, say that that figure of deferred income would represent an amount available for distribution?

A. I would say it would not represent an amount available for distribution in the year April 30, 1947.

Q. Well, Mr. Claypoole, isn't it true that these parties may have had cash in that amount, they received it in the year, possibly, let's say, 1946.

A. They may have had cash, this may have been represented by cash in part, at least.

Q. Well, the part that was represented by cash, would you consider that, as an accountant would you consider that or would you advise somebody that they could treat that as available for distribution?

A. I would advise them that it was not available for distribution.

Q. Why?

A. Because the work hadn't been completed. There was [43] work to be performed under the various contracts.

Q. Do you know what this item Bad Debt Adjustment is, Mr. Claypoole?

A. It is, so far as I can tell from the Revenue Agent's report, a reversal of a bad debt charge-off.

Q. I get down now to a figure of \$30,632.10. You state here on your schedule income not avail-

(Testimony of Paris B. Claypoole.)

able for distribution per books, tax return and RAR. Wherein does the Revenue Agent's report say that that is not available for distribution?

A. That is reflected in the balance sheet of the corporation and the corporation's tax return which shows precisely what the \$30,000 was used for by the corporation.

Q. And do you say that from your analysis you have determined that Revenue Agent Phillips took that into consideration at least at one point in his report?

A. At one point, yes, sir, in Exhibit Q.

Q. Did he not take it into consideration in some other place in the report?

A. He did not take it into consideration in the surplus account.

Q. And where is that located in the report? To refresh your memory, is that page 58?

A. Page 58 of the Revenue Agent's report.

Q. I see from your analysis that you arrived at a surplus after deducting these items we have just gone through [44] very carefully plus income taxes in the amount of \$43,885.88, and dividends, he arrived at a surplus of \$11,097.01, while you arrive at a deficit surplus of \$11,857.56. How do you explain that, Mr. Claypoole?

A. Well, he did not take into the surplus account those items not available for distribution or he did not show them in any schedule which would represent a surplus reserve not available for distribution.

(Testimony of Paris B. Claypoole.)

Q. Well, what precisely? What income items were used by Revenue Agent Phillips to show surplus available for constructive dividends for the fiscal year April 30, 1947 according to your analysis of his reports? A. After a deduction—

Mr. Machtinger: If the Court pleases, is the witness now testifying from a specific exhibit of the Revenue Agent?

Mr. T. Baird: Yes, we are down at the bottom of this exhibit.

Mr. Machtinger: Right now in this answer, I would like to know to what exhibit you are referring of the Revenue Agent.

The Witness: May I have that question again?

Q. (By Mr. T. Baird): I would like to know what income items your analysis shows Revenue Agent Phillips to have taken into consideration to show surplus available for constructive dividend distribution [45] as of April 30, 1947.

A. He used—

Q. Well, now in answer to Mr. Machtinger's question, wherein in the Revenue Agent's report are you going to find these figures?

A. Exhibit D, page 58.

Q. Shows what?

A. He used \$132,682.27 and deducted from that income taxes and the item of \$2,714.42 and charged against surplus \$52,489.47 and \$22,495.49. Now, he had previously showed that in Exhibit Q there were certain items not available for distribution which are, as he treated it in effect, a reserve

(Testimony of Paris B. Claypoole.)

charge against surplus for the year April 30, 1947.

Q. Well, at the bottom of your schedule, Mr. Claypoole, you have a list of items here that you claim on the schedule were used by Revenue Agent Phillips. That is what my question was directed to. I don't believe you answered it specifically. The items listed at the bottom of your schedule on Petitioners' Exhibit 16, the same items that we have been talking about that you claim were not taken into consideration in Exhibit D on page 58.

A. The explanation is this. When you use \$132,000 as the income surplus credit and you charge against the income taxes and those items are of \$30,632.10 which were not available for distribution, you arrive at a result which means that [46] you have to find out what items were used and by going back to that you find first there was an error made in the matter of stated income taxes of \$6,533.38. If Mr. Phillips had used the correct figure or——

Mr. Machtinger: I object to that testimony.

The Court: Well, he is giving his opinion. It doesn't mean Mr. Phillips is wrong. It means that this witness is expressing his view. Mr. Phillips will get a chance to justify his figures, if necessary.

Q. (By Mr. T. Baird): Go on, Mr. Claypoole.

A. If Mr. Phillips had used the \$50,419.26 instead of the \$43,885.88, there would have been \$6,533.38 less available for distribution. Had Mr. Phillips charged against the available surplus the \$6,000 item as not available for distribution, there

(Testimony of Paris B. Claypoole.)

would have been \$6,000 less. The same thing is true of the \$1,860.40, the \$49,210.15, and the \$3,703.50 item.

Q. Mr. Claypoole, isn't it true, if Mr. Phillips didn't use any amount as a deduction that it would, of course, make less available for distribution? What I am getting at is do you believe that the amounts that Mr. Phillips showed on Q-1 of his report and on Schedule Q were sound from an accounting sense as to make adjustments to what was available for distribution? Do you believe those were sound for distribution? Do you believe those were sound from the accounting sense? [47]

A. I do.

Q. You believe that they could have been treated as available for distribution from an accounting sense?

A. I do not believe they could have been treated as available for distribution or properly treated as available for distribution.

Q. All right, Mr. Claypoole, we arrive now at a total figure of \$97,939.53, as you have shown on your schedule. What does that figure represent?

A. That is a figure out of which the \$74,984.96 shown on Exhibit Q was taken.

Q. And is that the same figure, is that a total of the same figures that were used in the deficiency notices for the years 1946 and 1947?

A. Do you refer to the \$74,000 item?

Q. I refer to the \$97,000.

A. No, sir, that is not.

(Testimony of Paris B. Claypoole.)

Q. You show a figure, Amount Not Used in Computation, \$22,954.57. What do you mean by that?

A. There was \$97,939.53 of income from which, against which the \$74,984.96 was applied. Now the difference is \$22,954.57.

Q. Have you been able to arrive at any conclusion or opinion as to where that \$22,000 came from? A. Yes, sir. [48]

Q. Where did that come from?

A. The \$22,000 is made up of two items and Mr. Phillips' Exhibit D, page 58, he shows a surplus of \$11,097.01 whereas by using these figures, the way they are used in this testimony, there was a deficit of \$11,857.56. Now, those two figures total \$22,954.57.

Q. Just so the record will not be confused, Mr. Claypoole, any more than it has to be, you have here Dividend Per 90-Day letter, \$74,984.96. Where did you get that figure from?

A. That is a figure which came from Exhibit Q which was broken down on the basis of—came from Exhibit Q as distributable both Clark and Koyl.

* * * * *

Q. (By Mr. T. Baird): I see you have a \$74,000 figure on Exhibit 16 and on Exhibit 15, your first schedule, Mr. Claypoole, you have a 90-day letter total figure of \$91,728.12. Do you mean by the \$74,984.96 that that is the figure that was used on Schedule Q in the Revenue Agent's report?

(Testimony of Paris B. Claypoole.)

A. That was used in Exhibit Q, as the amount distributable from the year 4/30/47. There has been added to that, however, in the calendar year reports on the individuals a sum which was determined from a subsequent fiscal year of the corporation.

Q. What subsequent fiscal year?

A. 4/30/1948.

* * * * *

Q. (By Mr. T. Baird): Mr. Claypoole, looking at Exhibit 16, your schedule entitled Comparative Analysis of Surplus for Year Ended April 30, 1947, you have near the bottom of the page Dividend Per 90-Day Letters. Did you mean dividends per RAR? A. No, sir.

Q. At that point?

A. I meant per Revenue Agent's report and not the 90-day letter.

Q. And did you also mean at the bottom of the page that the last item Dividend Per RAR instead of 90-day letter of \$74,984.96? [50]

A. Yes, sir.

Q. I just wanted to clear the record on that.

Mr. Claypoole, will you look at Schedule Q—

Mr. T. Baird: At this time, before we look at Schedule Q, I would like to offer in evidence as Petitioners' Exhibit 16—

Mr. Machtinger: No objection, your Honor.

The Court: Very well.

The Clerk: Petitioners' Exhibit 16 admitted in evidence.

(Testimony of Paris B. Claypoole.)

(Petitioners' Exhibit No. 16 was received in evidence.)

Q. (By Mr. T. Baird): Mr. Claypoole, referring again to Schedule Q of the Revenue Agent's report, I see here a column entitled E, Total Distributions Per RAR, a total amount of \$74,984.96. Then I see a breakdown under Gene Clark for the years 1946 and 1947. Will you, for the record, state what the amount shows available for distribution per Revenue Agent's report for the year 1946?

A. \$44,227.13.

Q. And will you also show the amount available for distribution in 1947?

A. \$8,262.34.

Q. Mr. Claypoole, from your analysis of this report, [51] have you been able to ascertain how these figures were arrived at for each of the two years?

A. No, sir.

Q. Mr. Claypoole, you are apprized are you not, that the fiscal year, first fiscal year of the corporation, ended on April 30, 1947, is that true?

A. That is correct.

* * * * *

Q. (By Mr. T. Baird): I will ask you a hypothetical question, Mr. Claypoole. If a corporation started doing business on May 1, 1946 and had a fiscal year ending April 30, 1947, accumulated assets, let us say a great amount of which was cash from cash sales [52] and supposing that the officers of this hypothetical corporation were on a calendar year basis. Could those officers of this

(Testimony of Paris B. Claypoole.)

hypothetical corporation have received, in your opinion as an accountant, any dividends in the year, calendar year 1946?

A. That is qualified to this extent, that first, the profits are not determined until the close of the corporation's fiscal year and no amount available could be determined until the year's close or at the close of the fiscal year.

Q. What is one of the major factors to take into consideration of what is available for distribution at the close of any fiscal year of any given corporation, Mr. Claypoole?

A. The profits of the corporation.

Q. What liabilities in particular?

A. Well, of course, the principal liability is that of income taxes and, in California, State franchise taxes.

Q. Is it your opinion that in this hypothetical case that I have just presented to you that a dividend could not be distributed to the shareholders who were on a calendar year basis for the year 1946 when the fiscal year of the corporation ended April 30, 1947?

A. I would say that none could be determined as available for distribution in the calendar year 1946.

The Court: You mean that no matter what the interim figures were there could be no dividend?

The Witness: There could be a dividend, but when it is determined to be available. No one

(Testimony of Paris B. Claypoole.)

would know until the close of the fiscal year what if anything were available.

The Court: It is your opinion that that is necessarily so in all cases?

The Witness: Yes, sir.

The Court: All right.

Q. (By Mr. T. Baird): Even in cases where there is a great amount of cash that could have been available?

A. An operating company would of necessity have to determine its profits for the year before it could determine whether there was anything available and until the close of the fiscal year it would be impossible to determine what would be available because there may have been substantial losses which may have wiped out prior profits that were earned in a prior period, in the calendar year.

The Court: Wouldn't that apply to every second of a corporation's existence except the split second at the end of the fiscal year because two days later they might lose something the next year?

The Witness: Well, the end of the year, I believe that a sum could be determined that would be available.

The Court: At that time?

The Witness: At that time, yes, sir. [54]

The Court: But a week later, it might not be available?

The Witness: That is true, sir.

The Court: All right, go ahead.

(Testimony of Paris B. Claypoole.)

Q. (By Mr. T. Baird): May I add for the record that this hypothetical corporation had a zero surplus when they started, when they were organized as a corporation, and if I put that into the record, would you answer the same way, Mr. Claypoole? A. Yes, sir.

Q. Would you be more apt to answer that way—could a corporation have a surplus when they start out, when they organize, in an accounting sense?

A. Not an earned surplus. They might have a paid-in surplus.

Q. That is what I mean, an earned surplus.
* * * * * [55]

Mr. T. Baird: I offer this in evidence as Petitioners' next in order.

The Clerk: 17. Petitioners' Exhibit 17 admitted.

(Petitioners' Exhibit No. 17 was marked for identification and received in evidence.)

Q. (By Mr. T. Baird): I now show you, Mr. Claypoole, a schedule marked "Gene Clark, Inc., Disposition of Income Reported in Return, Fiscal Year April 30, 1947." Did you prepare this schedule, Mr. Claypoole? A. Yes, sir.

Q. What does it purport to cover? What is included in it?

A. It shows the disposition of the income or all receipts and disbursements from the day the corporation was started on May 1, 1946 to April 30, 1947.

(Testimony of Paris B. Claypoole.)

Q. Is it, in effect, an explanation or clarification of the debits and credits in the balance sheet, Mr. Claypoole? A. That is correct.

Q. And what is this Surplus Account you have marked at [56] the bottom of the schedule, Mr. Claypoole?

A. That is a reconciliation between the \$30,-632.10 reported in the tax return and the surplus as set forth in the closing balance sheet of \$21,-897.09. That is in there because the Reserve for Income Tax, \$8,735.01, is not a profit and loss adjustment. That is a surplus charge.

Q. And where in this schedule would the \$21,-897 that you have marked here as surplus, I believe, .09, where would that fall in your schedule here?

A. Well, that's the remainder between the debits and the credits, between the opening and closing balance sheets and the reserve for income tax of \$8,735.01.

Q. What I am getting at, would that have been taken up in the items that you have marked on this schedule Income Reported in Return?

A. Yes, sir.

Q. And will you list those items, please, that you have marked?

A. Do you want me to read?

Q. I just want you to read them for the record, not the amounts.

A. Purchase of real estate; purchase of trucks

(Testimony of Paris B. Claypoole.)

and equipment; improvements to buildings and leasehold; purchase of office equipment; notes receivable from officers; note paid off; accrued taxes, insurance, wages, et cetera; increase of cash on [57] hand.

Now, offsetting that are a decrease in accounts receivable, a decrease in inventory, a decrease in deferred charges, acquisition of trust deed, which is a liability; an increase in accounts payable, deferred income as a liability, reserve for depreciation——

Mr. Machtinger: If your Honor please, the record speaks for itself. I don't see the necessity of going through and listing all these debits and credits.

The Court: I'd like to ask this witness one hypothetical question, though, before we get too far away from his recent opinion.

Assume that a corporation was formed on January 1st, 1954 and that on December 31st, 1954 it had net earnings after taxes of \$100,000, and assume that on July 1st, 1954 it had distributed to its stockholders \$50,000. Would you say that that \$50,000 was or was not an ordinary dividend from the income tax standpoint?

The Witness: I would say it was an ordinary dividend.

The Court: All right, thank you. Go ahead.

Mr. T. Baird: I see that I forgot to have this marked for identification. I would like to have it

(Testimony of Paris B. Claypoole.)

marked for identification and at the same time offer it as petitioners' next in order.

The Clerk: Exhibit 18. [58]

* * * * *

Cross Examination

Q. (By Mr. Machtinger): Mr. Claypoole, have you examined all the books and records of the corporation? A. No, sir.

Q. Have you recomputed or attempted to recompute the net income of the corporation or have you made all your schedules from the Revenue Agent's report and the income tax returns of the individuals, as well as of the corporation?

A. They have all been made from those reports.

Q. Referring to Petitioners' Exhibit 15, your first item is Income Per Tax Return of \$30,632.10, to which you add \$102,050.17, representing adjustments to the taxable income per the agent's report. You then arrive at \$132,682.27. First, Mr. Claypoole, would you say that the income tax per return of [59] \$30,632.10 is income which should be considered in order to arrive at what is available for distribution? A. It should be considered.

Q. Why do you deduct it from the \$132,682.27 in coming to a figure of what is available for distribution?

A. Because it had been used by the corporation for purposes other than distribution.

Q. But if you are arriving at a total income of the corporation, don't you take into account the full income of the corporation before you make any

(Testimony of Paris B. Claypoole.)

deductions from that income to arrive at income available for distribution? A. Yes, sir.

Q. Have you prepared a schedule showing in what manner that \$30,632.10 was used so that it was not available for distribution?

A. That is reflected in the balance sheet of the corporation, balance sheet with the return.

The Court: What was this use, Mr. Claypoole? Let's not keep it a mystery.

The Witness: It was used for the purchase of machinery, trucks, real estate, paying off note, paying various bills, reserve for depreciation, taxes, for all the corporate uses of that nature.

Q. (By Mr. Machtinger): So that your deductions go back to what is contained [60] in the balance sheet as attached to the income tax return of the corporation, is that correct? A. Yes, sir.

The Court: Is it your idea that because funds are not in cash they can't be distributed?

The Witness: No, sir.

The Court: Well, I must say that I don't follow you on the \$30,000-odd-dollar item. If you have any more explanation, I'd be glad to have it.

The Witness: Well, in this computation that was made in the Revenue Agent's report, he arrived at a theoretical amount available for distribution. Now, that is something after the corporation has actually used funds for specific purposes and the remainder then represents an amount that he sets up as available for distribution.

The Court: Do I understand you to mean that

(Testimony of Paris B. Claypoole.)

if a corporation has an earned surplus of \$100,000 and has put it into equipment or anything of that sort that it is not available for distribution?

The Witness: It is not available in a physical sense. The assets could be distributed, a building could be distributed.

The Court: You could go down to the bank and borrow something and distribute, too, couldn't you?

The Witness: Yes, sir.

The Court: All right, go ahead. [61]

Q. (By Mr. Machtinger): Mr. Claypoole, if the Gene Clark Corporation showed a surplus at the end of the fiscal year '47 and distributions were made to the stockholders during the calendar year 1946, would you say that there were no distributions to the stockholders during that calendar year that were taxable?

A. If the corporation showed a distribution, yes. If it showed a distribution, it would be reflected here.

Q. If the stockholders receive what might be termed constructive dividends, dividends that were not shown as such on the books of the corporation, and the corporation showed a surplus at the end of the year, would there not also be taxable dividends to the stockholders?

A. In certain circumstances. If the corporation shows that. In this case, I am working from actually what the record shows.

Q. What if the facts show that, Mr. Claypoole, hypothetically? Would you not agree that there

(Testimony of Paris B. Claypoole.)

were taxable dividends to the stockholders during the year, calendar year 1946?

A. To the extent of surplus available. If the facts disclosed that distributions had actually been made by the corporation.

Q. Since you have not examined all the books and records of the corporation, you are not then in a position to say whether or not there were any actual distributions to the [62] stockholders that were not reflected on the books and records, is that correct? A. That is correct.

Mr. Machtinger: That is all the questions we have.

Mr. T. Baird: No questions, your Honor.

The Court: All right, thank you, Mr. Claypoole.

Mr. T. Baird: If you wanted to ask a question, I will allow it. Just a minute, Mr. Claypoole.

Q. (By Mr. Machtinger): Mr. Claypoole, were the books and records of the corporation available to you?

A. I will have to qualify that. When I came into the case, they were subpoenaed in a court case and for weeks were across the street in the courthouse. They were not, at no time did I have an opportunity to make the kind of an investigation of the books that would qualify me to say that I have examined the books.

Q. Did you make a demand, you or your counsel make a demand for those books on the persons who had the books and records of the corporation?

A. Yes. Well, I didn't put it in any form of

(Testimony of Paris B. Claypoole.)

demand, but I asked to see the books. They were busily engaged with those records at that time and then about that period they were taken into this case in the State court and they were not available until about the latter part of this past week. [63]

Q. Did you ever make a demand for any books and records which was denied?

A. I didn't make a demand. I am just the——

The Court: Mr. Machtinger, he said he didn't examine them in any real sense.

Mr. Machtinger: No more questions, your Honor.

The Court: All right, Mr. Claypoole, thank you.

(Witness excused.)

Mr. T. Baird: Your Honor, the petitioner rests.

The Court: All right.

Mr. Machtinger: If the Court please, I would like to make a motion for judgment as set forth in the notice of deficiency in this case on the grounds that petitioners have failed to bear their burden of proof that the Commissioner erred in his 90-day letters.

The Court: What is the situation with respect to limitations for the years 1946, '47, '48, and '49?

Mr. Machtinger: With respect to the year 1946, the year is closed unless respondent proves fraud. With respect to the year 1947, please correct me if I am wrong, the year is closed unless respondent proves fraud or that there was an understatement of income by the petitioner of more than 25 per cent. There is no limitation question with respect to the years 1948 and 1949.

The Court: The motion is denied with respect to the [64] years 1946 and 1947 and is held under advisement as to the years 1948 and 1949 until the matter is considered on the merits.

Mr. Machtinger: Thank you, sir.

Mr. T. Baird: I won't cite my cases now, your Honor.

The Court: Go ahead.

Mr. Gardner: If the Court please, at this time respondent would like to waive the fraud as to Mrs. Clark for the years '46 and '47 at which time she filed individual tax returns.

The Court: Very well.

* * * * *

Y. L. CREED

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Y. L. Creed, C-r-e-e-d, 101 Andrea [65] Lane, Arcadia.

Q. (By Mr. Gardner): Mr. Creed, would you state your business? A. General contractor.

Q. Referring specifically to the year 1946, what business were you in?

A. I was a contractor.

Q. Would you state whether or not you had any business connections or any contracts with Gene Clark, Inc.? A. Yes, I did.

(Testimony of Y. L. Creed.)

Q. Would you state what business you had with the Gene Clark Plumbing?

A. Well, he plumbed four houses for me, I believe it was.

Q. Do you have the addresses on those houses?

A. Yes, I do.

Q. Would you state that?

A. Well, first one was 5965 Otis Avenue in Huntington Park and 5961 Otis Avenue and 5957 Otis Avenue, all in Huntington Park, and one at 4355 East 56th Street in Maywood.

Q. And what amounts, if any, did you pay to Mr. Clark?

Mr. T. Baird: Define your question.

Q. (By Mr. Gardner): What amounts, if any, did you pay to the Gene Clark, Inc., for the work performed?

Mr. T. Baird: If your Honor please, before the [66] witness answers, may I inquire as to what period of time you are interrogating the witness?

Mr. Gardner: I should have cleared that up, your Honor.

The Court: All right, go ahead.

Q. (By Mr. Gardner): At what time was the work done on these houses, Mr. Creed?

A. Between January and May, I think.

Q. Of what year, Mr. Creed? A. '46.

Q. January and May of '46? A. Yes.

Q. Do you know whether or not you were dealing with a corporation or with a partnership, Mr. Creed?

(Testimony of Y. L. Creed.)

A. Well, I didn't particularly know, I didn't inquire into it, no.

Q. The contract was made some time around February of '46, is that correct?

A. Well, I think they was made at different times. All I can refer to is the date I took out the permits, and the first one was taken out in December, December 26 of '45, and we started on it a week or so later, which is after the first of the year. And the next one was taken out January 11 in '46, and the next one January 15th in '46, and the last one was in [67] March, 22nd, in '46.

Q. Do your records reveal how you paid the amounts, if any, to the Gene Clark Plumbing?

A. Well, I am not clear on it, but I sold Mr. Clark one of those houses and he paid me a down payment on it outside of escrow and the rest of it evidently was straightened up in escrow because it it all marked paid here the same day, which is June 13th, 1946, and we straightened up after it went into escrow with the house, and I suppose that is the day I marked them all paid.

Q. Mr. Creed, I hand you a document signed by you on the 10th day of February, 1953 in an effort to refresh your recollection.

A. That seems to be correct, sir.

Q. Do you now recall how the——

Mr. A. Baird: May I see that, Mr. Gardner?

Mr. Gardner: Yes, sure.

In the interest of saving time, is there any objection to introducing this?

(Testimony of Y. L. Creed.)

Mr. A. Baird: If your Honor will bear with us just a moment. We will stipulate that the amounts are correct but not as to certain dates in there.

Mr. Gardner: As to being a payment out of escrow and this amount, is that correct that we have?

Mr. A. Baird: The amounts appearing on this document [68] are substantially correct, your Honor. We are not sure that they are absolutely accurate but sufficiently so for the purpose of this case. I am not certain of the dates.

Mr. Gardner: Would you mark this respondent's exhibit next in order?

The Clerk: Respondent's Exhibit O.

The Court: It is marked at this point for identification, I assume?

Mr. Gardner: I am going to put it into evidence, your Honor. There is no objection.

Mr. A. Baird: We would object to the affidavit itself, but I thought we could save time if we agreed with you about the amounts.

Mr. Gardner: You would object to the affidavit?

Mr. A. Baird: Yes.

Mr. Gardner: It is stipulated that the amounts paid by Mr. Creed on the four houses mentioned before in the testimony are \$680, \$680, \$742.50, and \$820, for a total of \$2,922.50.

(Respondent's Exhibit O was marked for identification.)

Q. (By Mr. Gardner): Now, Mr. Creed, would you state how that amount was paid?

(Testimony of Y. L. Creed.)

A. Well, to the best of my recollection, we straightened it up in escrow when we went through the escrow, and that is all [69] I remember about it and that's the reason I think every one of them is marked paid the same day. That evidently is when it was straightened up. I marked them all paid.

Q. Did you pay some of it by a personal check, Mr. Creed?

A. Yes, I paid the first payment I paid by a check which I have here.

Q. Would you give us the date of that?

A. That is the only check that I gave him, \$544.

Q. And the date on there is?

A. February 5th, '46.

Mr. Gardner: Would you mark this as respondent's exhibit next in order?

The Clerk: Respondent's Exhibit P.

Mr. A. Baird: No objection.

(Respondent's Exhibit P was marked for identification and received in evidence.)

The Court: Is this paper in evidence in whole or in part yet?

Mr. Gardner: Not yet, your Honor, just what I have read. He is merely using this to refresh his recollection.

The Court: All right.

Q. (By Mr. Gardner): You stated, I believe, that Gene Clark purchased a home or purchased a house from you. Was the remainder of the [70] balance which you owed to him, was that taken care

(Testimony of Y. L. Creed.)

of in this house or did you reduce the price on the house?

A. No, no, I sold the house to him for \$8,500 and when we went into escrow, why, he gave me credit for this amount.

Q. Did that appear in the escrow?

A. I imagine it did, I don't remember.

Q. Would you refer to your——

A. Well, I don't have my book on it. All I kept, just the cost sheet on the thing.

Q. But it was deducted from the price of the house? A. As I recollect, yes.

Q. The balance of \$2,378.50 was deducted, Mr. Creed?

A. That is the total of these jobs.

Q. That is the total of the jobs less the \$544 check?

A. Well, as I say, it's been nine years ago and the best of my recollection was yes.

Q. All of the remaining, in other words, was taken care of? A. Through the escrow.

Q. In reducing the cost of the house to Mr. Clark, is that correct? A. That's right.

Q. Thank you, Mr. Creed.

Is that your signature, Mr. Creed?

A. Yes, it is. [71]

Q. Did you make that statement of your own free will? A. What did you say?

Q. Did you make that statement of your own free will? A. Yes.

Mr. Gardner: At this time respondent moves to offer this into evidence.

Mr. A. Baird: Well, if your Honor please, I think it's been covered by the witness. This is an affidavit given by him in connection with this investigation to Special Agent Coons. It is self-serving in nature and we object to it for that reason.

The Court: May I see it, please?

I thought you took the position, Mr. Baird, that you objected only to the affidavit part or the date part of it.

Mr. A. Baird: No, I stated that I was not certain as to the dates contained in that document as to when certain payments were made. We are not making any complaints about the amounts. I don't think it is a matter of any great consequence to us one way or the other so far as that is concerned.

The Court: Neither do I, but if it is not admitted into evidence, then we may have to go back over the question of these dates. The check, as I understand it, is in evidence for \$544, is it?

Mr. Gardner: Yes, your Honor.

The Court: That has a date on it, no doubt. [72]

Mr. A. Baird: May I say, your Honor, that we will withdraw our objection if we may reserve the right to make such further check as might be necessary.

The Court: Well, I am satisfied to let it in subject to check and rebuttal testimony.

Mr. A. Baird: We will withdraw our objection, then.

The Court: It will be received.

(Respondent's Exhibit O was received in evidence.) [73]

* * * * *

TRUMAN JOHNSON

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Truman Johnson, 213 West Garvey Boulevard, West Covina.

Q. (By Mr. Gardner): Would you state your business, Mr. Johnson?

A. I am a general contractor, among other things.

Q. Referring specifically to the year 1946, on or about November of that year, did you at that time—would you state whether or not you had any business dealings with Mr. Gene [75] Clark?

A. I did.

Q. What was the business dealings that you had, Mr. Johnson?

A. I was building some houses in West Covina, and he did some plumbing jobs for me.

Q. Will you state whether or not you sold a house to Gene Clark? A. I did.

Q. Would you state the terms under which that house was sold?

A. I believe the price was \$22,000, if I recollect, and he paid me cash for part of it and did some plumbing jobs for the balance.

(Testimony of Truman Johnson.)

Mr. Gardner: Would you mark this for identification?

The Clerk: Respondent's Exhibit Q marked for identification.

(Respondent's Exhibit Q was marked for identification.)

Mr. Gardner: Would you mark this for identification, please?

The Clerk: Respondent's Exhibit R marked for identification.

(Respondent's Exhibit R was marked for identification.) [76]

Q. (By Mr. Gardner): Mr. Johnson, I hand you Respondent's Exhibit Q and ask you what that is.

A. This is a contract that Gene Clark Plumbing Company entered into with me for the plumbing of some houses in West Covina.

Q. What is the price shown on there, the estimated price? A. \$930.

Q. I hand you Exhibit R and ask you what that is.

A. This is a contract for plumbing 10 houses.

Q. And what is the total amount of that contract? A. \$3,300.

Q. Is this the contract that was given to you, Mr. Johnson?

A. I believe so, it looks like it.

Q. What was the usual cost per unit, Mr. Johnson, at that time for houses?

A. Well, I paid him \$930 for some and——

(Testimony of Truman Johnson.)

Mr. A. Baird: I object to that answer as not being responsive to the question. The question was what was the usual price. The witness answered, "I paid him." I move that it be stricken, the part that he answered.

The Court: I don't know what the usual price has to do with this, but I will be glad to hear from you, Mr. Gardner. [77]

Mr. Gardner: I will withdraw the question, your Honor.

Q. (By Mr. Gardner): I believe you stated that Mr. Clark, or Gene Clark, Inc. did some plumbing work for you on certain houses on Glendora Avenue, is that correct, Mr. Johnson?

A. Glendora Avenue, yes, sir, that is correct, and Barbara Avenue.

Q. Referring to those specific houses, what was the price which you expected to pay for the plumbing in those houses per unit?

A. I don't know how to answer that question. The contract there states the prices I paid.

Q. Were those prices low, Mr. Johnson?

A. \$3,300 was.

Q. What would you ordinarily pay for those houses?

A. Well, previously I paid him \$930 for some.

Mr. T. Baird: I move to strike that answer, it is not responsive to what would you ordinarily pay. If you want to restrict the question, what did you pay Mr. Clark before——

(Testimony of Truman Johnson.)

Mr. Gardner: I will carry on the cross, Mr. Baird, if you don't mind.

The Court: What was the fair price at the time, if you know?

The Witness: Well, that's a little difficult to [78] answer, what the fair price was.

The Court: Were there any special circumstances about this contract at which you got a special discount or cut rate, or weren't there?

The Witness: Part of the difference between those two sums was part payment for the house he bought from me.

Q. (By Mr. Gardner): And how much was that?

A. I assumed it was \$600 per contract.

Q. That is the contract for \$3,300 for the 10 houses was \$600 per unit less?

A. That's what I considered, yes, sir.

Q. And that was part consideration for the house which he purchased from you?

A. That is correct.

Q. Why was the deal handled in that manner?

A. Mr. Clark asked to have it handled that way.

Mr. Gardner: At this time I would like to introduce Respondent's Exhibits Q and R.

Mr. A. Baird: No objection.

The Clerk: Respondent's Q and R admitted in evidence.

(Respondent's Exhibits Q and R were received in evidence.)

Q. (By Mr. Gardner): How much was the total

(Testimony of Truman Johnson.)

amount of this, Mr. Johnson? [79] \$600, 10 houses, was it \$6,000? A. That would equal \$6,000.

Q. Did that \$6,000 appear in your escrow arrangement?

A. I am quite sure it did. On my books, I showed that I received \$22,000 for the house and I assume, I don't recall what the escrow statement said, but I am very sure that my books showed that I gave him credit for \$6,000 as part payment for the house, in connection with it.

Mr. Gardner: No further questions.

The Court: Your books reflected the full contract price.

The Witness: That is correct.

The Court: Which was in excess of the written contract price.

The Witness: My books showed that I received a benefit of \$6,000 from Mr. Clark.

Cross Examination

Q. (By Mr. T. Baird): Mr. Johnson, you stated on your direct examination that you sold this home to Gene Clark. I show you Respondent's Exhibit Q and R and ask you to read what it states. Does it state on a stamp on both Exhibits Q and R, Gene Clark, Inc.? A. It does so.

Q. 101 East Garvey, El Monte, California?

A. That's right. [80]

Q. Do you know whether or not you were dealing with Gene Clark, Inc. or Gene Clark as an individual?

(Testimony of Truman Johnson.)

A. It's nine years ago, I assume since that says Gene Clark, Inc. that I was dealing with Gene Clark, Inc.

Q. Thank you.

Mr. Gardner: We will stipulate that it was sold to Gene Clark, Inc., the corporation.

The Court: Well, is counsel willing to stipulate who or what entity took title?

Mr. T. Baird: Yes, your Honor, I will so enter into a stipulation that it was bought by Gene Clark, Inc.

The Court: And you agree with that, Mr. Gardner?

Mr. Gardner: Yes, I do, your Honor.

The Court: All right.

Q. (By Mr. T. Baird): Now, Mr. Johnson, the price of your home, \$22,000—you stated you are in the contracting business, did you not?

A. Yes, sir.

Q. You consider that price a little high for a home such as you sold to Gene Clark, Inc.?

A. No, it was a bargain at that price.

Q. We are interested in values here, Mr. Johnson, and I would like to know whether or not at this particular time, in 1946 I believe it was, you said,—

A. I didn't say when. [81]

Q. When was this transaction? When did it take place?

A. Well, I don't recall exactly, it could have been '46 or '47 for all my memory.

The Court: Doesn't it show on the contract?

(Testimony of Truman Johnson.)

Mr. T. Baird: Q is '46 and R is '47, your Honor.

The Court: All right, then it would be one each year. We will say 1946 and assume the transaction occurred then.

The Witness: Could have been.

Q. (By Mr. T. Baird): Do you think that you could have gotten plumbing per unit at \$600 per house? A. No.

Q. From any plumber in those days?

A. No.

Q. In 1946, I mean. A. No.

Q. You think you could have gotten it for \$600 per unit in 1947? A. No.

Q. Isn't it true, Mr. Johnson, that plumbing prices came down quite considerably between 1946 and 1947? A. I don't believe so.

Q. Did they remain constant or did they go up?

A. They were at their peak along at that time.

Q. Along at what time?

A. Along in '47.

Q. Were they also at their peak in '46?

A. They were going up in '46.

Q. You stated that Mr. Clark asked to have it handled that way. Did you not feel that this was a beneficial way for it to be handled for yourself?

A. No.

Q. And it was not you that requested it?

A. I didn't request it. As a matter of fact, I objected to it.

Mr. T. Baird: No further questions.

Mr. Gardner: No redirect. [83]

* * * * *

BEN LANG

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Ben Lang, 4060 East 54th Street, Maywood, California.

Q. (By Mr. Gardner): Mr. Lang, what is your business? A. I am an owner-builder.

Q. Referring to the year 1948, what was your occupation? A. Owner-builder.

Q. Will you state whether or not you had any business dealings with Gene Clark?

A. I have.

Q. Referring specifically to the date on or about April 21st, 1948, did you have any business dealings with Mr. Clark?

A. Thinking back that far, without some records, I wouldn't want to say.

On April 20, 1948, that check was signed by me, no doubt.

Mr. Gardner: Please mark the check as Respondent's exhibit next in order.

The Clerk: Respondent's Exhibit S marked for identification. [84]

(Respondent's Exhibit S was marked for identification.)

The Clerk: Respondent's Exhibit T marked for identification.

(Testimony of Ben Lang.)

(Respondent's Exhibit T was marked for identification.)

Mr. A. Baird: We will stipulate. Are these marked?

Mr. Gardner: These are marked for identification, S and T.

Mr. A. Baird: We are willing to stipulate that the witness, Ben Lang, paid Gene Clark, Inc.—well, I am not sure. The invoice is Gene Clark, Inc. and the check is made to Gene Clark, so I don't know.

The Court: Why can't we stipulate that the invoice is Gene Clark, Inc. and that the check is Gene Clark and let it in evidence so we can see what the endorsement shows?

Mr. A. Baird: There is no objection to that. That endorsement on the back is Gene Clark.

The Court: What we are trying to get at are the facts.

Mr. A. Baird: No objection to the documents being offered.

The Court: Very well.

Mr. Gardner: Will you further stipulate that this is in payment for plumbing work? [85]

Mr. A. Baird: Yes, we will.

Mr. Gardner: And that the check was issued in response to the invoice, Exhibit T.

Mr. A. Baird: Yes, we will so stipulate. What does the endorsement on the check show, Mr. Gardner?

Mr. Gardner: The endorsement shows Gene Clark.

(Testimony of Ben Lang.)

The Court: I understand these came in without objection.

The Clerk: Respondent's Exhibits S and T admitted.

(Respondent's Exhibits S and T were received in evidence.)

Q. (By Mr. Gardner): Was there any particular reason, Mr. Lang, why this check was made to Gene Clark personally, do you recall?

A. I don't recall of any particular reason.

Mr. Gardner: No other questions.

Mr. A. Baird: No questions. [86]

* * * * *

FRANCES B. BITTINGER

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Frances B. Bittinger, 608 Leonard Street, Montebello.

Q. (By Mr. Gardner): Mrs. Bittinger, what is your occupation?

A. At the present time, I am secretary and treasurer of the Hamilton Sales Corporation.

Q. Referring specifically to the year 1947, what was your occupation?

A. 1947, I was assistant secretary and treasurer of Hamilton Homes, Inc. as well as Hamilton Sales Corporation.

(Testimony of Frances B. Bittinger.)

Q. What were your duties, Mrs. Bittinger?

A. Well, I was assistant bookkeeper and office manager.

Q. Did you issue any checks? A. Oh, yes.

Q. Was that part of your job?

A. That was part of my job, yes, sir, all checks, everything, all bills came over my desk.

Q. You prepared certain other records to show why the checks were disbursed? [87]

A. Yes, I did.

Q. What was the basis for the issuance of checks?

A. Well, the bills on the Hamilton Homes, Inc. came into my desk approved by the building superintendent for payment, and I would check it against the contract and if it was in balance or warranted payment, why, the checks were issued.

Mr. A. Baird: These may all be offered as far as we are concerned.

Mr. Gardner: Will it also be stipulated that these checks were issued in payment for the invoices as shown?

Mr. A. Baird: Well, I think the invoices speak for themselves. I prefer you ask the witness that.

Mr. Gardner: All right.

Would you mark this as respondent's next in order.

The Clerk: Respondent's Exhibit U marked for identification.

The Court: There is no need to mark them for identification. Counsel has stated that he has no

(Testimony of Frances B. Bittinger.)

objection to their coming in. They can come in and then Mr. Gardner can still ask the witness such questions as he may care to in explanation.

The Clerk: Exhibit U admitted in evidence. Respondent's Exhibit V admitted in evidence. Respondent's Exhibit W admitted in evidence.

(Respondent's Exhibits U, V, and W were marked for identification and received in evidence.) [88]

Q. (By Mr. Gardner): Mrs. Bittinger, I hand you Exhibit U and ask if you have seen that before and, if so, what is it?

A. I have, this is an invoice and a check and we at one time used a voucher system of proving the payment of this particular job here. This invoice covers the finish only for some tract houses that we were building on Bleakwood Avenue.

Q. The check was issued in payment of the invoice, is that correct?

A. That's right, yes, it is.

Q. I hand you Government Exhibit V and ask you to explain that exhibit, if you know.

A. This, likewise, is an invoice, check, and a voucher for billing issued to us on July 9, 1947. It covers 60 houses, tract houses, covering houses built on tracts 13296 and 13297 and 13584. That is for rough-in plumbing.

Q. And the check was issued in payment?

A. That's right.

Q. Of the invoice?

A. That's correct.

(Testimony of Frances B. Bittinger.)

Q. I hand you Exhibit W and ask you what that is.

A. This check is for \$2,295, dated September 16, 1947, to Gene Clark, Inc. and covers 17 panel rays installed on our tract houses on Bleakwood Avenue.

Mr. Gardner: No further questions. [89]

Mr. A. Baird: We have no questions.

The Court: All right, thank you.

(Witness excused.) [90]

* * * * *

[Endorsed]: Filed April 18, 1955.

[Title of Tax Court and Docket Nos. 48542-3-4.]

Los Angeles, March 31, 1955

9:30 o'clock a.m.

PROCEEDINGS

* * * * *

LLOYD GEORGE MEISSENBURG

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Lloyd George Meissenburg, M-e-i-s-s-e-n-b-u-r-g, 3924 North Charlotte, Rosemead.

Q. (By Mr. Gardner): Mr. Meissenburg, what is your occupation?

(Testimony of Lloyd George Meissenburg.)

A. Plumbing contractor.

Q. Referring to the year 1948, what was your occupation at that time?

A. Same, plumbing contractor.

Q. Did you ever purchase any plumbing supplies from Gene Clark, Inc.?

A. I did.

Q. How did you pay for those supplies?

A. By check and by cash. [102]

Q. Do you have the checks with you, Mr. Meissenburg?

A. Yes, I do.

* * * * *

Q. Was any other payment made by you to Mr. Clark or to the Gene Clark, Inc. in addition to the two checks that have been recently marked for identification?

A. Yes, I gave him \$12,000 in currency.

The Court: Who did you turn it over to physically?

The Witness: Gene Clark.

Q. (By Mr. Gardner): Where did you get the currency that you paid to Mr. Clark?

A. From the First State Bank of Rosemead and Bank of America in El Monte.

Q. Was there any particular reason that you used cash for this transaction, Mr. Meissenburg?

A. Not that I recall. [103]

* * * * *

Q. I hand you Respondent's Exhibit MM and ask you if that is the check which you used to pay Gene Clark?

A. Yes, it is.

Q. To whom did you give that check?

(Testimony of Lloyd George Meissenburg.)

A. To Gene Clark.

Q. And what was it for?

A. Plumbing materials.

Q. I hand you Exhibit LL and ask you what that is.

A. That was a check for which I gave to Gene Clark for plumbing materials.

Q. Do you have the dates?

* * * * *

The Witness: This last check that the gentleman [104] handed me was for plumbing materials I purchased from Gene Clark.

Q. (By Mr. Gardner): On what date was the payment in cash made, Mr. Meissenburg?

A. March 2nd, 1948.

Q. I hand you Exhibit OO and ask if you have ever seen the original of that document?

A. Yes, I have.

Q. Would you state what it is?

A. It is materials I purchased from Gene Clark.

Q. I hand you Exhibit NN and ask if you have seen the original of that document.

A. Yes, I have.

Q. What is that?

A. For plumbing materials purchased from Gene Clark.

Q. Is that an itemized account of the plumbing materials which you purchased?

A. Yes, it is. [105]

* * * * *

Q. (By Mr. Gardner): Did I understand cor-

(Testimony of Lloyd George Meissenburg.)

rectly, Mr. Meissenburg, was the cash issued in payment for materials? A. Yes, it was.

Q. Were the checks issued in payment for materials? A. Yes.

Mr. Gardner: No further questions.

Cross Examination

Q. (By Mr. T. Baird): Mr. Meissenburg, do you know whether or not when you sold these materials you were dealing with Gene Clark, Inc. or Gene Clark Plumbing?

A. No, all I know, I was dealing with Gene Clark. I didn't know if it was incorporated or a company, just what it was.

Q. I show you Respondent's Exhibit MM, a check in the amount of \$22,935, bearing the date 2/9/48. Will you state for the record who that is payable to the order of? A. Gene Clark.

Q. And will you look at the back of the check and see who endorsed the check? Will you state that? A. Gene Clark.

Q. I now show you Respondent's Exhibit LL. That is a [106] check dated 1—

Mr. Gardner: If the Court please, we will stipulate that it was payable to Gene Clark and signed by Gene Clark. The document speaks for itself.

The Court: The checks are already in evidence. I don't know what this witness can add to them. Certainly, it is not necessary to point out the endorsements. I mean, you can ask him anything else you want, but that's already in the record.

(Testimony of Lloyd George Meissenburg.)

Mr. T. Baird: Thank you.

Q. (By Mr. T. Baird): You stated on direct examination that something happened on March 2nd, 1948. I didn't catch what happened.

A. That was when I gave Gene Clark \$12,000 cash.

Q. Mr. Meissenburg, I wonder if you could relate to the Court what the transaction, tell us a little bit about the transaction and how long a period it covered? In other words, what I am getting at, how many deliveries were made and whether this was one transaction or a series of transactions or just what the situation was.

A. Well, as I recall, there were several loads of material that we picked up from Gene Clark's yard and I believe it was divided between rough and finished material for which we made payments as we got certain amounts.

Q. Approximately what was the first date that you [107] picked up materials from the yard, do you know?

A. I don't recall.

Q. Was it before you made payment by check?

A. It was prior.

Q. Or after or about that time?

A. We picked the material up first and paid him for it after it was in our yard.

Q. And how many times did you pick material up in this series of transactions?

A. Well, there was quite a bit of material there. I would say there was about ten truckloads. Our truck has an 18-foot bed on it.

(Testimony of Lloyd George Meissenburg.)

Q. I mean, was it over a period of, say, a month?

A. I would say a month, yes, as I recall.

Q. And the later check, the check dated 2/9/48, would that check have been issued about the time that you picked up material or a little after?

A. A little after, yes.

Q. And would you have paid the cash to Gene Clark a little after, some time after a delivery that was previously made?

A. I would say yes because we did receive the material before we paid for it.

Q. Would you state who was present when these deliveries were made at the yard of Gene Clark?

A. Well, Gene Clark was present and whoever the men were that he had working for him, and I had one fellow working with me from my shop.

Q. Specifically, was Archie Koyl present at any of those deliveries?

A. No, I find that in recalling my business with Archie, I didn't know Archie until after I had bought this material from Gene Clark, when he took over the company.

Q. You mean to say that Archie Koyl was not present at any of the times these deliveries were made, he was not loading material on the truck?

A. No, he wasn't. I believe I talked to you about that.

Q. Yes, you did, and that is why I am surprised.

A. I didn't know him at the time. After recalling my relationship with Archie, it was after he

(Testimony of Lloyd George Meissenburg.)

bought out Gene Clark, whatever the circumstances were, and we bought material back and forth from each other at that time, and that's where those dealings came.

Q. All right, that is all.

The Court: Do you recall whose idea it was to pay the substantial amount in cash? I am just asking you whether you recall, I don't want you to guess at it.

The Witness: No.

The Court: You either recall or you don't.

The Witness: No, I really don't recall whether we [109] suggested it or whether Gene suggested it.

The Court: All right, any further questions?

Mr. T. Baird: I have one more question, your Honor, if I may.

Q. (By Mr. T. Baird): I will try to refresh your memory. I know it is pretty hard to go back all those years. Do you recall whether Mr. Archie Koyl was present at any time when material was delivered to your establishment?

A. No, I don't recall.

The Court: Well, which one of the two establishments was he dealing with? Which establishment of Gene Clark were you dealing with? He had two places, didn't he?

The Witness: Yes.

The Court: Which one were you dealing with?

The Witness: I was dealing with the one in El Monte.

Mr. T. Baird: That is all, your Honor.

(Testimony of Lloyd George Meissenburg.)

Mr. Gardner: Could I ask one or two more questions?

Redirect Examination

Q. (By Mr. Gardner): When you picked up the material, Mr. Meissenburg, would you state just where you got it? A. From El Monte.

Q. Was it Gene Clark Plumbing?

A. Pardon? [110]

The Court: He has made it clear that he picked it up at the Gene Clark Plumbing, Gene Clark plant.

The Witness: We didn't pick up any material from his other place.

Q. (By Mr. Gardner): Was this material you picked up separated in any way from the other material that was there?

A. We picked up all the rough material. There wasn't too much finished material, which consists of fixtures and such as that.

Q. Was it all together in the same yard?

A. Yes.

Q. Was there any separation there that you could tell, other than that separating rough and finished?

A. Well, he made some deliveries himself. I don't know where that came from.

Q. But speaking of the material you picked up——

A. I picked up everything from El Monte, yes.

Q. And this wasn't set apart in any way, was it? A. No.

Mr. Gardner: No further questions.

The Court: In order to pick up a loose end, would counsel be willing to inform me and the record as to whether or not Gene Clark Plumbing or any organization purporting to operate under that name filed a partnership return during any [111] of the years in question?

Mr. T. Baird: I will be willing to stipulate that they did not, your Honor.

The Court: You will be willing to stipulate the same?

Mr. Machtinger: Yes, sir, not only that there was not a partnership return filed, but to my knowledge no other return, an individual tax return by Gene Clark and a corporation return by the corporation.

The Court: Do you agree with that?

Mr. T. Baird: I do. [112]

* * * * *

FREDERICK W. FILES

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address, please.

The Witness: Frederick W. Files, F-i-l-e-s, 850 North Palm Avenue, Whittier, California. [122]

Q. (By Mr. Machtinger): Mr. Files, what is your occupation?

A. At the present time, I am employed by the

(Testimony of Frederick W. Files.)

Valley City Supply Company as a credit manager.

Q. How long have you been employed with that company? A. Since August of '49.

Q. Prior to your employment with that company, by whom were you employed?

A. By Gene Clark, Inc. and Gene Clark Plumbing.

Q. And when did you first start with Gene Clark, Inc. or Gene Clark Plumbing?

A. In August, I mean in February of '45.

Q. And what was your position with Gene Clark Plumbing or Gene Clark, Inc.? What were your duties?

A. I was the controller and the office manager.

Q. Were you the controller on or about the date of May 1, 1945? A. Yes.

Q. Do you recall that as being the approximate date when Gene Clark, Inc. was formed?

A. Yes.

Q. Under whose direction did you work as controller of the corporation?

A. Under the direction of the officers.

Q. Who were the officers?

A. Gene Clark was president, Archie Koyl was vice president, [123] and we had various secretaries.

Q. What were your duties as controller?

A. To handle the office end of the business, supervise the books, make the collections, take care of the odds and ends in connection with payrolls and all of the office work.

(Testimony of Frederick W. Files.)

Q. As controller, were you familiar with the manner in which the books were being prepared and being kept up and the manner with which——

A. Yes.

Q. Were you familiar with the manner in which the corporation handled its cash that it received from sales? A. Yes.

Q. Were you familiar with the manner in which the corporation handled its stock and inventory?

A. Yes.

Q. Were the preparation of the books and the care of the books left to your discretion or did you work under the direction of one of the—immediate direction of any of the officers?

A. Not so far as the books were concerned.

Q. Mr. Files——

Mr. A. Baird: Just a minute, may I get that answer clarified? You mean that you took care of the books and handled the books and directed what went into the books on your own initiative?

The Witness: No, I just handled the entries in the [124] books.

Q. (By Mr. Machtinger): To correct the record, I believe I asked you whether or not the corporation was incorporated as of May, 1945. Was it not '46?

A. Oh, yes, I believe you are right, sir. The seal says April 23rd, 1946.

Q. '46? A. That is what is on the seal.

Q. How many shops or places of business did

(Testimony of Frederick W. Files.)

the corporation have during the time you were employed with it? A. Two.

Q. Where were they located?

A. One at Five Points in El Monte, I believe the address was 10,100, and another one at 6833 Eastern Avenue in Bell Gardens.

Q. Did you work at both shops? A. Yes.

Q. Was there one set of books for both shops?

A. Yes.

Q. And one set of entries for sales and receipts for both shops? A. Yes.

Q. Did the corporation sell for cash at any time while you were with the corporation? [125]

A. Yes.

Q. And what type of transactions? Were these daily transactions through people that came to the shop? A. Yes.

Q. Did you handle the bank deposits of the cash? A. Yes.

Q. Could you explain to the Court your usual procedure in taking care of the cash received through daily transactions?

A. We maintained consecutively numbered duplicate receipt books in both shops. When cash was received on what we might call open account receivable, the entries were made when the checks or money came in in the receipt book, which was really a memorandum that was transferred later to the cash receipts journal in the books of account. We maintained the receipt book for two reasons. One was to give the customer a receipt if he wanted

(Testimony of Frederick W. Files.)

it, and the second one was to maintain a daily record in both shops that was accessible to the office girls or any of the supervisory help, so that when I came back to that at a later date there was a complete record of what went on while I was gone or before I put the entries in the books.

Cash sales were accumulated daily or perhaps several times a week, tapes were run on them, and a receipt was generally written for the total amount of a certain group of sales. The deposits were made and recorded generally weekly, and I would generally record my deposit in the receipt book, too, as a [126] memorandum record.

Q. Did you enter all of the sales, cash sales, at the shops as a record in the sales journal?

A. No, sir, they'd be grouped together as one lump sum entry.

Q. And did you enter the cash receipts in the cash receipts journal?

A. As one lump sum entry.

Q. Did you regularly deposit the cash that you received through your daily sales?

A. I regularly deposited all that was turned over to me for such purpose.

Q. Who would turn over the cash to you?

A. Mr. Clark.

Q. How would he get the cash? Was he the officer who was making the sales over other people in the shop?

A. Other people were making sales, too.

(Testimony of Frederick W. Files.)

Q. And what was done with the cash that other people received?

A. Brought into the office and put in the cash box along with a ticket.

Q. How would Mr. Clark obtain the cash?

A. By just taking it.

Q. And did he turn over to you the total amount received each day for deposit in the bank account?

A. I am not certain, I don't know. He turned over to me all that I reported.

Q. Well, is there a difference between the amount you recorded and the amount of cash sales that were made by the corporation?

A. There was.

Q. And what represented that difference?

A. Amounts that would have been withheld and not turned over to me for deposit.

Q. The amounts that were withheld, were they amounts realized from sales of corporate supplies or inventory?

A. Sales of supplies and inventory in our yard, yes, sir.

Q. With respect to those amounts that were withheld, was any record made in the corporate books and records of the sales of those items?

A. No.

Q. To the extent that the amounts — that cash was withheld, were you not, as controller, concerned with getting a correct figure of receipts of the corporation so that the correct income could be computed?

A. Yes.

(Testimony of Frederick W. Files.)

Q. Did you feel that your records—was it your opinion that the records did correctly reflect the total sales and income of the corporation?

A. They reflected what was turned over to me to enter [128] into the books, yes.

Q. Well, did they reflect the total amounts of sales of the corporation? A. No.

Q. Was it not your responsibility to see to it that the corporation books and records did reflect the total amounts of sales?

A. It was my responsibility to ask about it, which I did.

Q. Of whom did you ask? A. Mr. Clark.

Q. When you say you asked Mr. Clark, what is it that you asked Mr. Clark?

A. Well, I remonstrated that we might be open to criticism for such action, and Mr. Clark told me that he'd handle his end of the business and I'd handle mine.

Q. Did the same practice go on at both shops of the corporation or only at the El Monte Shop, which I understand Mr. Clark managed?

A. The Bell Gardens shop, when I would pick up and record cash sales at the Bell Gardens shop, I would simply record what was left there for me to record. I have no knowledge of just exactly how, if there were, differences.

Q. You do have knowledge that there were differences in the El Monte shop? [129]

A. Correct.

Q. In the course of your work with the Gene

(Testimony of Frederick W. Files.)

Clark Corporation, do you have any knowledge as to whether at any time supplies or inventories were removed from the stock of the corporation which were not reflected on the books and records of the corporation? A. Yes.

Q. And would you explain to the Court under what circumstances that occurred?

A. Well, I would see material leaving the premises on which there would be no corresponding compensation made on the books of the corporation for such shipments.

Mr. T. Baird: Excuse me, counsel, could we have dates?

Mr. Machtinger: I will get into dates, yes.

Mr. T. Baird: Thank you.

Q. (By Mr. Machtinger): You stated you were employed with the corporation at the time that it incorporated on or about May 1, 1946?

A. Yes.

Q. Can you state whether or not you recall as to whether any cash was turned over to Mr. Clark which was not reflected on the books and records of the corporation during the balance of the calendar year 1946? In other words, between May and December 31st of 1946? [130]

A. Well, our procedure wasn't changed any. The procedure of cash sales, I might say, was not changed any after incorporation.

Q. And during the year 1947, did the same practice continue? A. Yes.

Q. And during the portion of the year 1948 that

(Testimony of Frederick W. Files.)

Mr. Clark was with the corporation, did that practice continue? A. Yes.

Q. During the year 1948, Mr. Clark was with the corporation during the entire year, was he not?

A. Yes.

Q. It continued during the year 1948?

A. I beg pardon?

Q. And it continued during the year 1948?

A. Yes.

Q. Did it continue through the portion of the year 1949 which, I believe, was during all of January and perhaps a few days in February?

A. Yes.

Q. And with respect to the withdrawals of inventories in the form of plumbing supplies and other plumbing materials, during the balance of the calendar year 1946, between May and December, 1946, do you recall whether or not there was any removal of supplies which were not reflected in the corporate [131] books and records?

A. Only to the extent that it was a daily occurrence, you might say.

Q. Under whose direction were these supplies removed?

A. Mr. Clark's. Mr. Machtinger, when you say "removed," you mean sold?

Q. Do you know as a matter of fact whether those supplies were being removed for purpose of sale?

A. Those would be the only ones I would pay any attention to. I wouldn't pay any attention to a

(Testimony of Frederick W. Files.)

truck leaving the yard with material for a job or something like that.

Q. Was it not customary, the customary practice to record in the books and records of the corporation——

Mr. A. Baird: Mr. Machtinger, I haven't objected, but I don't think you should lead this witness.

Mr. Machtinger: All right.

Mr. A. Baird: I want to get along here as rapidly as we can.

The Court: I agree that they shouldn't be leading, but this witness isn't being either led or misled up to the moment. I think it is a rather consecutive picture and Mr. Machtinger seems to be trying to save a little time, but if you feel there is an element of being leading, then he will have to rephrase his questions. Very well. [132]

Q. (By Mr. Machtinger): What was the customary procedure that was followed with respect to the books and records of the corporation and in entry into those books and records of the corporation when there was a sale of materials from the supplies on hand?

A. Just a cash sale and not a contract sale, you mean?

Q. Yes.

A. The material would be delivered to the customer, a ticket would be written, and he would either give us currency or a check, and it would be put in the cash receipts box.

(Testimony of Frederick W. Files.)

Q. With respect to your testimony of materials going out for what you understood were sales and which were not reported to you, was the same procedure followed with respect to the books and records?

A. I don't follow that, sir.

Q. You testified, Mr. Files, that there were times when Mr. Clark either took or sold materials which left the yard and for which there was no entry in the books and records?

A. Correct.

Q. Now, were those, was it ever your understanding that those materials were going out as goods sold rather than on contract jobs?

A. Yes.

Q. And there were times when there were not entries in the books and records for those goods that were going out?

A. Yes. [133]

Q. And did that occur at any time to your recollection during the period May 1, 1946 to December 31, 1946?

A. I can't recall any specific shipment, but it was a regular occurrence.

Q. And during 1947, was it a regular occurrence?

A. Yes.

Q. During 1948?

A. Yes.

Q. And during 1949, to the best of your recollection, up to the time when Mr. Clark left the corporation?

A. Yes.

Q. Mr. Files, you were with the organization prior to May 1, 1946, were you not?

A. Yes.

Q. Could you strike that question, please?

Mr. Files, was there ever an occurrence when

(Testimony of Frederick W. Files.)

someone would bring a check to you and substitute it for cash proceeds that you had received during that date? A. Yes.

Q. Will you explain how that would occur?

A. Well, if I had cash available in the safe as proceeds of sales made for cash, Mr. Clark would have a check that he wanted me to cash, I'd cash it for him.

Q. Was that check which he would cash ever a check received in consideration for the sale of corporate goods? [134]

A. Not by me. In other words, I had no record of it.

Q. You had no record of it? A. Yes.

Q. Were those his personal checks, Mr. Files?

A. No, they would be third-party checks.

The Court: Do you know whether they were customer checks?

The Witness: They would be made out to Gene Clark, Inc.

The Court: Do you remember whether any substantial number of them were from makers that you knew to be customers of Gene Clark, Inc.?

The Witness: Yes.

Q. (By Mr. Machtinger): Did that practice occur, to your best recollection, during the calendar year 1946 between the dates of May and December of that year? A. Yes.

Q. And during the year 1947? A. Yes.

Q. And during the year 1948? A. Yes.

Q. And during the first month of 1949?

(Testimony of Frederick W. Files.)

A. Yes.

Q. Mr. Files, you were with the corporation, with the [135] organization before it incorporated, were you not?

A. Yes.

Q. Was the organization located in the same place before it incorporated as after it incorporated?

A. The same two places, yes, sir.

Q. After incorporation, did you keep one set of records for a corporation and any other set of records for any other organization?

A. Just kept one set of records for the corporation.

Q. Were materials segregated in the yards or was there one supply of materials which the corporation drew on?

A. There was no segregation to my knowledge.

Q. Were the workers in the yards who would load the trucks that went out employed by the corporation or by any other party?

A. By the corporation.

Q. Were the workers paid by the corporation?

A. By the corporation, yes, sir.

The Court: Mr. Machtinger, it may be that, with counsel's permission, I am going to want to ask a few questions along those lines myself when you get through and possibly prior to cross examination in order to give an opportunity for it. I would rather go into it as a whole. I think it is a good time to recess until five minutes after eleven.

(Short recess.) [136]

The Court: Go ahead.

(Testimony of Frederick W. Files.)

Q. (By Mr. Machtinger): Mr. Files, did you handle the books and records of the corporation or supervise the entry in the books and records prior to the date on which the organization incorporated?

A. Yes.

Q. At the time of incorporation, was the inventory that was on the books and records of the prior organization picked up as the organization inventory of the corporation?

A. I believe that there was some adjustment, I don't recall what. There was a fresh inventory for incorporation.

Q. Was it a detailed inventory, item by item inventory? A. Item by item inventory.

Q. Did you take it? A. No, sir.

Q. Who took it? A. Mr. Clark.

Q. He gave you a figure?

A. He gave me a figure.

Q. At any time during incorporation, was there an inventory taken of the supplies and stock and other items on hand? A. Yes.

Q. At that time, was there a separation made of what was purported to belong to the corporation and what was [137] purported to belong to any other entity?

A. Not given to me that way, no.

Q. To your knowledge, was the inventory as given to you, did it represent, to your knowledge, the entire inventory on hand? A. Yes, sir.

Q. Did that include the fiscal year of the corporation ending April 30, 1947? A. Yes, sir.

(Testimony of Frederick W. Files.)

Q. April 30, 1948? A. Yes, sir.

Q. And at the time when Mr. Clark withdrew from the organization, on or about February 4, 1949?

A. That inventory I took myself.

Q. And did that inventory that you took include everything that was in the yards and in the stock of the organization?

A. That inventory included everything.

Q. Do you recall, Mr. Files, the transaction between the organization and the Valley Boulevard Plumbing and Electric Company on or about January, during the months of either January or February, 1948?

A. I recall seeing their trucks and personnel removing material from the yard, yes, sir.

Q. Is that the organization with which, to your knowledge, [138] Mr. Meissenburg is associated?

A. Yes, sir.

Q. Did the workers or employees of the corporation load those trucks? A. Yes, sir.

Q. Were those workers paid by the corporation?

A. Yes, sir.

Q. I hand you what is identified as Respondent's Exhibits LL and MM, which are two checks from the Valley Boulevard Plumbing and Electric Company to Gene Clark. Do the books and records to your knowledge record in the sales journal a sale by the corporation to the Valley Boulevard Plumbing and Electric Company in these amounts?

A. No, sir.

(Testimony of Frederick W. Files.)

Q. That is, there is not a sale to your knowledge of \$3,074.74 nor of \$22,935?

A. Not recorded in the books of the corporation, no, sir.

Q. Do you recall whether or not the corporation recorded a sale to the Valley Boulevard Plumbing and Electric Company for which there was received \$12,000 in either cash or by check?

A. No, sir. [139]

Q. Did you make any inquiry with respect to these items and with respect to the removal of the materials from the yard to Mr. Clark?

A. Yes, sir.

Q. What did you ask Mr. Clark?

A. I first asked him if it was all right. He said he was handling the deal, for me not to be concerned with it.

The Court: Was there anything further said?

The Witness: No, sir.

Q. (By Mr. Machtinger): To your knowledge, Mr. Files, was Mr. Clark aware that these sales were not being recorded on the books and records of the corporation? A. Yes, sir.

Q. How do you know that he was so aware?

A. Because Mr. Clark was familiar with the corporate books and how we made the entries and no entry was given to me or no data was given to me to enter on the books on this transaction.

Q. Did you ask him or point out to him that it should be entered on the books and records of the organization? A. Yes, I did.

(Testimony of Frederick W. Files.)

Q. And do you recall, as best you can, specifically what he replied?

A. He replied that this was a deal that he was handling [140] himself and was no concern of mine.

Q. Did you point out to him that the books and records would not reflect the true income of the corporation?

Mr. A. Baird: Just a moment, if your Honor please, this has been gone into and it has been asked and answered many times.

The Court: I think the last question is proper, Mr. Baird, unless you are willing to concede the facts in it.

Will you read that last question, please?

(Question read.)

Mr. A. Baird: I will withdraw my objection.

The Witness: Yes.

Q. (By Mr. Machtinger): What did he reply to you?

A. That it was a situation that he would take care of it, he would worry about it himself, it was no concern of mine.

Q. While you were with the organization, Mr. Files, did the organization ever dispose of any machinery or equipment or automobiles?

A. Yes, there were frequent transactions of that nature.

Q. How did the organization dispose of those? Were they sold? A. Some.

Q. And the others? [141]

A. Traded, maybe.

(Testimony of Frederick W. Files.)

Q. And did you keep an accurate record of the transfers of the corporate assets that were disposed of?

A. We had a complete record of the corporate assets on the books. Everything was set up and evaluated as closely as we could. Assets that were carried over from the proprietorship, such as office fixtures and furniture, had to be estimated, but any equipment that was acquired at a later date by the corporation was set up at its cost value.

Q. Were you supplied with the appropriate invoices or sales slips and proceeds from the sales of these assets so that you could make the proper entries in the books and records?

A. On some.

Q. Why do you qualify that statement, Mr. Files?

A. Because on some of them I wasn't. I was simply handed a check and told to remove certain assets from the books, the proceeds of the check.

Q. Did the check that you were handed ever represent a payment for plumbing supplies purchased from the organization?

A. Could have been.

Q. Do you recall, to the best of your knowledge, whether a check was ever handed to you which was in payment of plumbing supplies of the organization and which check you applied against the sale of the corporate assets?

A. I can't recall any specific instrument, no.

Q. Do you recall, Mr. Files, a sale of an auto-

(Testimony of Frederick W. Files.)

mobile to the Las Vegas Plumbing and Supply Company?

A. I recall the name, Las Vegas Supply or Las Vegas Plumbing and Supply.

Q. Do you recall whether or not the Las Vegas Plumbing and Supply ever purchased plumbing supplies from the Gene Clark organization?

A. I believe that I was offered a sale or a check or something to that effect, some slip, a memorandum. I can't recall the exact details.

Q. Do you recall whether or not a cash receipt from the Las Vegas Supply Company was ever applied to remove a Chevrolet pick-up truck, 1947 Chevrolet pick-up truck?

A. I can recall that, yes, sir.

Mr. Machtinger: That is all the questions I have of this witness on direct.

Mr. A. Baird: Just one moment.

The Court: Mr. Baird, I don't insist upon this, I mean, normally I wait until both direct and cross examination of a witness is concluded before I ask any questions, but there are a few questions I would like to ask this witness concerning which you may want to cross examine him and if you haven't any objection, I would like to do it now. I don't mean that you are waiving objections to the questions, but to the time.

Mr. A. Baird: We have no objection. [143]

The Court: All right. Mr. Files, after the corporation was organized, were there any books of ac-

(Testimony of Frederick W. Files.)

count kept as to transactions of Gene Clark Plumbing, insofar as you know?

The Witness: No.

The Court: Was there anyone in charge of the books at the plant or office except you?

The Witness: No.

The Court: Were there any books for any period subsequent to the organization of the corporation except for closing out the proprietorship in the office or wherever the books were kept of Gene Clark, Inc.?

The Witness: The only book that was kept in the office that had any connection with Gene Clark Plumbing was a check book on the Bank of America in El Monte.

The Court: Were the employees in and about the office who worked on the books under your direction?

The Witness: Those that worked on books, partially under my direction.

The Court: Were there any that weren't at least partially under your direction?

The Witness: No, sir.

The Court: Did any of them work for Gene Clark Plumbing so far as you know?

The Witness: No, sir.

The Court: Were any of them paid for services to [144] Gene Clark Plumbing so far as you know?

The Witness: No, sir.

The Court: Were there any transactions relating

(Testimony of Frederick W. Files.)

to Gene Clark Plumbing which went on the books of the corporation?

The Witness: No, sir.

The Court: Were you paid by Gene Clark Plumbing after the corporation was formed?

The Witness: No, sir.

The Court: Beyond perhaps a few days of overlap?

The Witness: No, sir.

The Court: Was there ever any circumstance or account or transaction which came to your attention relating to Gene Clark Plumbing subsequent to the formation of the corporation other than such matters as were necessary to close out Gene Clark Plumbing?

The Witness: No, sir.

The Court: All right, go ahead.

Cross Examination

Q. (By Mr. A. Baird): Mr. Files, with reference to the inventory that was taken over by Gene Clark, Inc., in May of 1946, can you give us any estimate or any idea as to the amount of inventory of supplies that was in the yard as of that time?

A. No, sir.

Q. Would you say that it was more than \$20,000 or nearer [145] \$100,000.

A. I couldn't say.

Q. Well, Mr. Files, isn't it a fact that the corporation was incorporated for about \$52,000?

A. I believe those are the figures, yes.

(Testimony of Frederick W. Files.)

Q. And isn't it true that in addition to certain trucks and necessary operating equipment that an additional amount representing material and supplies of approximately \$19,000-odd dollars was set up on the books as the inventory, your starting inventory?

A. I don't recall the balance sheet for the opening entries. I don't recall what the figures were.

Q. Would you say that the entire stock of supplies and material which was there in the yard on May 1st, 1946 when the corporation started business was included in the inventory?

A. To the best of my knowledge, it was, yes. We were handed—Mr. Kay and I were handed an inventory purported to be the entire inventory.

Q. Purported to be the entire inventory and if that represented only the inventory that was intended to be the inventory of the corporation, it nevertheless could be true that there was other material and other supplies that were not included in that statement? A. It could be.

Q. Isn't it true that during all of this period about [146] which you have been talking that people were constantly making checks to about three different units, that is the records so far show that we have checks coming to Gene Clark, that we have checks coming to Gene Clark Plumbing and that we have checks coming to Gene Clark, Inc.?

A. Yes.

Q. And didn't that state of confusion become so great that it was necessary for you to adopt a rub-

(Testimony of Frederick W. Files.)

ber stamp which you ultimately used on your checks in which you included, I believe, all three, or at least two, of those designations?

A. All three.

Q. So you could stamp any check?

A. All three, sir.

Q. And that was used throughout the entire period? A. Yes, sir.

Q. If this business was solely the business of Gene Clark, Inc., why was it necessary for you to adopt a rubber stamp that would incorporate transactions of Gene Clark individually or Gene Clark Plumbing?

A. That's true in any business, sir, that has the word "Inc." tacked on the end. Gene Clark was an individual, and when a contractor got an invoice from Gene Clark, Inc., he might write a check to Gene Clark Plumbing, he might write it to Gene Clark, or he might remember to write the words "Inc." on the end of it and he'd send it along, and I talked with the [147] bank, and they suggested the composite stamp, just stamp your deposits with your stamp and that will take care of all of them.

Q. Mr. Files, you were present prior to the time that Archie Koyl and Gene Clark formed the Gene Clark, Inc. corporation? A. Yes.

Q. And are you at all familiar, personally familiar, with the arrangement which they had relative to either salaries or division of profits prior to the time that the corporation was formed?

A. No. You mean for the proprietorship?

(Testimony of Frederick W. Files.)

Q. For the proprietorship, if we call it a proprietorship.

A. Well, during the period of the proprietorship, it was my understanding after all expenses, et cetera, were paid, Mr. Koyl was to share equally with Mr. Clark, but I don't know as a positive fact, just my general understanding.

The Court: May I interrupt a minute. Off the record.

(Discussion off the record.)

Q. (By Mr. A. Baird): Mr. Files,—

The Court: I might say this, Mr. Baird, I don't know what your contention may be beyond the year 1946. I don't recall the details of the opening statement, but in effect, it [148] was that Gene Clark Plumbing continued on as an operating organization. So far as I see at the moment, the schedule in 1946 has no particular dates in it. It purports to cover the year. So far, I haven't seen anything for subsequent years relating to any plumbing business as a separate organization, a good deal with respect to farms and so forth. I merely call that to your attention for whatever it may be worth.

Mr. A. Baird: Thank you, your Honor.

Q. (By Mr. A. Baird): Mr. Files, did you have anything to do with the making of the returns of Gene Clark, Inc. and Gene and Faye Clark, individually?

A. With considerable outside help, yes, sir.

Q. I notice on the 1946 return in Schedule 1, which has been introduced in evidence as Exhibit—

(Testimony of Frederick W. Files.)

if the Clerk will give me the exhibit number——

Mr. T. Baird: 53.

Mr. A. Baird: Exhibit 53. The individual return of Gene Clark for the year 1946, is that the correct number?

The Clerk: Yes.

Q. (By Mr. A. Baird): I notice that Schedule 1 of that return indicates wages received from Gene Clark, Inc., \$11,999.95, and income from business, Schedule 2, \$18,827.60. Can you tell us what that income from business was? [149]

A. Is this the individual return of Gene Clark's or is it the corporation one?

Q. No, this is the individual return.

A. I had nothing to do with his individual returns.

Q. You had nothing to do with the individual returns? A. No.

Q. Did you furnish the accountants who made the returns the data or information from which the returns were made?

A. In this particular instance, this was the calendar year '46, filed in '47.

Q. That is correct.

A. That information would have been furnished by Gene on his request or any authorized representative of his.

Q. Do you recall now anything about income that Gene Clark had in 1946, other than what he got in the way of wages from Gene Clark, Inc.?

A. Well, yes, if there was a close-out of proprie-

(Testimony of Frederick W. Files.)

torship to a corporation, there would have been wages from the corporation and income from the proprietorship in the same year.

Q. And it is also possible, is it not, that he might have had income from some other sources?

A. Yes.

Q. Now——

Mr. A. Baird: May I have the corporation income tax returns of Gene Clark, Inc., Mr. Clerk?

Q. (By Mr. A. Baird): While we are finding those, I will go on to something else.

Mr. Files, you have testified on direct examination that on certain occasions Mr. Clark would turn in a check to you and ask you to cash the check, and you would take the cash out of the safe or out of the cash box and give him the cash. A. Yes.

Q. Do you know whether or not he used that cash that he received from you in connection with his own personal private affairs or do you know whether or not he used it for the purchase of material for Gene Clark, Inc.?

A. I don't know what he did with it.

Q. Mr. Files, isn't it true and wasn't it a matter of common knowledge, I might say to the public generally in this area and more particularly to the administrative officers of Gene Clark, Inc., that plumbing materials were exceedingly scarce and that to operate a plumbing business during that period of time with which we are here concerned, that it was necessary on occasion and frequent occasions to pay cash? A. Yes.

(Testimony of Frederick W. Files.)

Q. In order to obtain material? A. Yes.

Q. And wasn't it a matter of common knowledge to you, Mr. Files, that rather extensive payments in cash were made to [151] a supplier in Tyler, Texas by the name of Mike Harvey?

A. I was so informed.

Q. And isn't it also true, Mr. Files, that you received invoices from the Mike Harvey organization, whatever the name of their corporation was, for materials that they had sent Gene Clark, Inc. and for which you sent them your check or your draft? A. That's right.

Q. So, if I understand the picture correctly, you would get a consignment of goods from Tyler, Texas, would receive an invoice for a specified amount, and would remit to them your check for that amount?

A. Most of the shipments were handled—all of them were handled on sight drafts bill of lading, but that is substantially correct.

Q. And that at the same time, contemporaneously with that transaction, at or about the same time, that there would be a substantial cash payment made to Mr. Harvey or his representatives?

A. That was my understanding, yes, sir.

Q. That was a matter of common discussion and talk in the office between you, Mr. Koyl, and Mr. Clark, was it not? A. Yes, sir.

Q. Will you tell us whether or not the cash payments thus made were included on your books as a

(Testimony of Frederick W. Files.)

part of the cost of [152] the cost of purchases of material?

A. No, sir, I only recorded what the invoice freight would amount to. [153]

* * * * *

Q. Very well, but you have testified that on occasion Mr. Clark would come to you and get cash, and you have testified that you didn't know what he did with the cash? A. Right.

Q. And, if I understand you correctly, you have stated that it was the general understanding that Mr. Clark paid cash, the over-ceiling amount of the transaction, to Mike Harvey and others?

A. That is correct.

Q. So, in that round-about way, we could say, could we not, that it was corporation money?

The Court: Well, all this witness is saying, Mr. Baird, is that the cash so paid out was not paid out of recorded corporation funds. It's been made abundantly clear. I don't—well, nobody knows the amounts, certainly, at this moment. It's been made abundantly clear that they made a lot of cash purchases and that the funds that were used were not on the corporation's books. It's also been made abundantly clear that they made a lot of sales and took in a lot of cash that wasn't recorded on the corporation's books and those funds or substituted funds or any funds might have been used.

All this witness is saying is that whatever that cash was that was paid out didn't come out of funds which he had recorded as corporate funds.

(Testimony of Frederick W. Files.)

Mr. A. Baird: Very well. [154]

Q. (By Mr. A. Baird): Mr. Files, to pursue another phase of the situation, I will ask you if it wasn't necessary and if, in fact, you didn't engage in transactions during this period wherein your company would exchange with some other dealer or some competitor, perhaps, certain material which you had which you didn't need quite as bad as some other material which your competitor had and that there would be an exchange of a quantity of material of one kind for a quantity of material of another kind? A. Yes.

Q. So that when you testified on direct examination a while ago that there would be goods going out of the yard for which you made no account, I'll ask you if that encompassed some of these transactions, these trading transactions?

A. Those trading transactions were generally items of, most of the time, not always, items of general knowledge in the office. Some plumber would call up and say, "I've got a righthand tub, you got a left-hand?" and they'd swap, and everybody would know about it. The yard boy would have to know about it. Sometimes there was even papers exchanged, sometimes.

Q. But there were instances, if I understand the statement you made to me during the recess, where there would be no records made of these transactions at all? A. That is correct, sir.

Q. With reference to the so-called cash transactions, [155] where checks were cashed, I under-

(Testimony of Frederick W. Files.)

stood your testimony on direct examination, some of those might relate to customers of Gene Clark, Inc. and other checks might be checks that had no relationship to a customer of Gene Clark, Inc.?

A. Could have been instances of which there was no relationship, yes.

Q. If I remember correctly in your testimony the other day, didn't you state that there were accommodation checks? A. Yes.

Q. And that that was a regular, more or less regular procedure at your place of business?

A. Yes.

Q. Where you were accommodating, I believe, the cleaning establishment or the market or others?

A. That's correct.

Q. Workmen who had salary checks?

A. Yes.

Q. And the like? A. Yes.

The Court: Were they comparatively large or small denominations?

The Witness: Relatively small, in sums ranging around a hundred dollars, your Honor.

The Court: All right, go ahead. [156]

Q. (By Mr. A. Baird): But those checks would go in with the other cash that you had received?

A. Yes.

Q. Do you know whether or not Mr. Clark kept any record, aside from what you call the records and books of the corporation, of the amounts that he had paid to Mike Harvey or others with whom he was dealing in cash?

(Testimony of Frederick W. Files.)

A. I don't know of any such records, no, sir.

Q. Did you ever see any such record?

A. No, sir.

Q. Did you ever ask him whether he had any such records?

A. I don't recall, sir.

Q. Wasn't it true, Mr. Files, that on some occasions that some of the people with whom you were dealing in cash insisted that there be no record made on your books or on their own?

A. I don't recall any specific instance of such.

Q. Wasn't that true with reference to the Keenan Pipe and Steel Company dealings that you and Mr. Koyl had with Fred Keenan?

A. I had no dealings with Fred Keenan.

Q. I believe Mr. Koyl had.

A. Yes.

Q. I do not know whether you can answer the question or not. [157]

A. Well, I have lost it now, sir. Would you—

Q. Let me ask again. Do you know whether or not there was any arrangement whereby it was agreed that the transactions between Gene Clark, Inc. and Keenan Pipe and Steel would be on a cash basis with no record made?

A. Yes, I knew of that arrangement, yes, sir.

Q. There was such an arrangement?

A. Yes, sir.

Q. And that was in existence during what period of time?

A. I first became aware of it early in '47, I believe.

Q. And that continued on through?

(Testimony of Frederick W. Files.)

A. Well, it continued on through '47, but there was no such arrangement to my knowledge in '48, resumed again in '49.

Q. Resumed again in '49? A. Yes.

Q. That is, during the year '48 when Mr. Koyl was away, there was no such arrangement?

A. Not to my knowledge, sir.

Q. Now, coming to another phase of this situation——

Mr. A. Baird: I may say that this may not be proper cross examination, but I will be glad to make the witness my own witness if it is in order and as a matter of accommodation to him. I do want to inquire something about the entries on the books and records with reference to notes receivable account and the trust deed account. [158]

The Court: Any objection?

Mr. Machtinger: No objection, your Honor. Go ahead. [159]

* * * * *

Q. (By Mr. A. Baird): Now, Mr. Files, there has been some testimony given in the case in which you appeared as a witness here earlier in the week, and while you are here I want to get you as the accountant to explain to us certain entries on the books which has to do with the acquisition of certain farm land in Kansas.

Now, I will show you first a notes receivable sheet from your journal ledger bearing the date 1946 and ask you, if you can tell us, what those entries relate to?

(Testimony of Frederick W. Files.)

A. It appears to be a general notes receivable account. However, I made none of these entries personally.

Q. Were they made under your supervision?

A. No.

Q. Can you tell us whether or not the particular page to which I am referring—this doesn't seem to have a page number on it, but it bears the date in the upper left-hand corner of 1946—as to whether or not that relates to notes receivable of the officers?

A. I am not certain, sir, the general ledger page such as this would not have a page number. The account number serves as the page number as well as an account number.

Q. Well, you see, I am not an accountant, so I wouldn't know that. At any rate, without some further analysis or [160] inspection, you cannot tell us at this time whether the entries on that page relate solely to accounts receivable from officers?

A. Well, I know that all of them don't. I recognize some entries.

Q. Do you know whether or not some of them do?

A. Yes. I can see one entry labeled West Covina, Journal Entry No. 19, in the amount of \$4,270. I believe that that pertained to the piece of property on Vine Avenue, but I would like to see the journal entry.

Q. That may not be important for our purpose at the moment. In connection with the acquisition

(Testimony of Frederick W. Files.)

of farm property down in Kansas, were you present at the time that it had been determined, or at least there was consideration given, to having the corporation acquire farm property in Kansas?

A. Yes.

Q. And were you with the organization at the time it was determined to reverse the field, so to speak, and acquire those properties for the individual officers? A. Yes.

Q. Did the corporation as such ever own any farm land in Kansas?

A. We tried to. I don't know if we owned it or not. I believe that we never were actually registered owners in Kansas, but I don't know.

Q. Do you recall whether or not you received some advice, [161] and when I say "you," I mean the officers of your company, from an attorney in Kansas to the general effect that you either could not own or could not operate farm lands in Kansas, a California company? A. Yes.

Q. There was some such legal advice obtained?

A. Yes.

Q. Can you look at the ledger sheets or the journal or wherever you would find it entered here and tell us whether or not there were any amounts advanced to Archie Koyl and Gene Clark for the acquisition of property down in Kansas?

A. On page 59 of the general journal under dates of April 30th, there is an entry regarding——

Q. What year?

(Testimony of Frederick W. Files.)

A. 1948—there is an entry regarding this transaction.

Q. And what is that entry?

A. It is a debit, cash on hand, and a credit to accounts receivable, officers, in the amount of \$20,000, to record the payment of \$20,000 on notes receivable, officers, by Mr. Gene Clark.

Q. With reference to that \$20,000 payment by Mr. Gene Clark, I will ask you if that \$20,000 wasn't the dividend which he received from Gene Clark, Inc. in 1948?

A. Yes, it was. The following entry explains that.

Q. In other words, he received a dividend in 1948 from [162] the corporation and turned it over to the corporation in partial payment of the notes receivable standing on the corporation's books?

A. That's correct.

Q. Do you know whether or not at the time—well, first let me ask you, that left a balance due from Gene Clark to the corporation as of that time of how much? A. \$27,518.99.

Q. Will you tell us, please, if you know, whether or not that amount was paid by Gene Clark and, if so, in what manner?

A. This entry is on the books, still on the books when I left the corporation.

Q. And when did you leave the corporation?

A. In July of '49.

Q. When you say it was still on the books, you mean that there was an account receivable on the

(Testimony of Frederick W. Files.)

books showing that the corporation was entitled to \$27,518 from someone and it had not been paid?

A. That is correct.

Q. Do you know whether or not in the negotiations made by Gene Clark with Archie Koyl at the time that Mr. Koyl re-purchased stock in the Gene Clark, Inc., in fact, all of the stock, that as a part of the deal Archie Koyl agreed to assume the liability of \$27,518.99? [163]

A. I don't recall the exact legal phrasing of the documents or anything like that. I know that it said there it remained on the books.

Q. Do you have any general understanding as to whether or not as a part of their deal Koyl was to assume Clark's liability to the corporation for that amount?

A. Do I have knowledge that he was supposed to?

Q. Yes. A. I don't recall.

Q. I notice with reference to the general ledger, it being general ledger Account No. 110, which reflects the item \$27,518.99 to which you have referred, which is the balance after the \$20,000 dividend had been applied against Clark's indebtedness of \$27,518.99, that you or someone have changed the heading on that ledger sheet from notes receivable, officers, to trust deeds. I will ask you whether or not that change was made by you?

A. No, sir.

Q. Is the heading, notes receivable, officers, which has been stricken out in your handwriting?

(Testimony of Frederick W. Files.)

A. No, sir.

Q. You did not make that entry?

A. No, sir.

Q. Were you, as controller of the company, familiar with the fact that you had an account of that kind on the books? [164]

A. Yes, sir.

Q. Do you know who made this change and for what reason that change of title was made?

A. Mr. Kay made that change in making certain closing entries at the end of the fiscal year. You will note the date.

Q. April 30, Mr. Kay made the change. Mr. Files, to your knowledge—I will withdraw that question.

A Ledger account headed trust deeds would indicate, would it not, that the corporation was the owner of certain trust deeds?

A. Yes.

Q. I will ask you whether or not to your knowledge the corporation ever owned any trust deeds of any kind from Kansas property or property elsewhere?

A. I never saw any.

Q. And is there any reason why you, as the controller and general business administrative officer of the company, would not have had the trust deeds in your custody and under your care if there were any in existence?

A. I should have had them, they were constantly promised to me, but I never got them.

Q. So that at the time that Gene Clark sold out to Archie Koyl this company didn't own any trust deeds, did it?

A. Not to my knowledge.

(Testimony of Frederick W. Files.)

Q. And the books and records do not indicate that it [165] owned any?

A. Except under the heading of this account.

Q. Except under the heading of this account which is written off, which was originally notes receivable?

A. That is correct, sir.

Q. I will ask you to look under the heading of the account as now changed, trust deeds, and see if there is anything on there to indicate that the company had any trust deeds?

A. No, sir, that is just an account title.

Mr. A. Baird: Mr. Machtinger, in the interest of saving time, will you stipulate that we may at the appropriate time introduce photostats of the minutes of the corporation?

Mr. Machtinger: Yes, at the appropriate time, if there is such an appropriate time.

Mr. A. Baird: I don't want to dismiss this witness and then not be able to identify them.

Mr. Machtinger: I want it to be clear that if it is in my opinion not an appropriate time, I will make such an objection.

The Court: Are the minutes here?

Mr. A. Baird: The minutes are here, yes.

The Court: Can he identify them generally? I don't know if what you are going to offer would be either material or timely or what, but why can't we settle whether they are the minutes? [166]

Mr. A. Baird: We have the minute books, your Honor, and we have made photostats of certain portions that might be pertinent.

(Testimony of Frederick W. Files.)

The Court: It seems to me you and Mr. Machtinger could get together on it. So far as this witness is concerned, it seems to me that there may be chances that he is going to be required. I have no objection to him being excused but I think it ought to be conditioned on the fact that counsel know where he is going to be and can call him, if necessary, upon reasonably short notice.

How far are you from this courthouse?

The Witness: It's San Gabriel, sir, on the freeway, about 30 minutes.

The Court: This case is going along to a point now where we want to conclude it, and witnesses must, to some extent, sacrifice their interests because some day they may be in the same position and need other witnesses.

Mr. Machtinger: I will stipulate.

The Court: Have you finished with this witness, Mr. Baird?

Mr. A. Baird: No, I have one more question.

Q. (By Mr. A. Baird): Mr. Files, I show you a joint exhibit, 12-L, which is the corporation income tax return of Gene Clark, Inc. for the fiscal year 1946, ending—fiscal year 1947, ending April 30, [167] 1947, to which exhibit there is attached a claim for refund bearing the signature Frederick W. Files, secretary-treasurer. I will ask you if that is your signature and if you prepared that claim for refund? A. Yes, sir, I did.

Q. And the date on that claim is what?

A. 27th. You mean under the notarization?

(Testimony of Frederick W. Files.)

Q. Yes. A. 27th of June, 1949.

Q. And can you tell us whether or not on the basis of that claim your company received a refund?

A. I don't really know whether they ever got the refund, sir. I was not with the company then.

Q. I now show you a joint exhibit, 13-M, which is the corporation income tax return for the fiscal year ending April 30, 1948 and ask you whether or not that return was prepared under your supervision and whether it bears your signature as controller?

A. It bears my signature as controller. It was prepared jointly by Mr. Kay and myself from the books and accounts and taken, I believe, to Mr. Hicks in Compton for checking and supervision of the entries and so forth and so on.

Q. And this return for that year was filed in the Director's office on July 14, 1948?

A. Purports to be from that stamp, yes, sir.

Q. I show you Joint Exhibit 14-N, which is a corporation income tax return of Gene Clark, Inc. for the year ending April 30, 1949.

A. Yes, sir.

Q. And ask you whether or not your signature appears there as an officer on that return, Frederick W. Files, treasurer? A. It does.

Q. That is your signature? A. Yes, sir.

Q. And did you prepare that return or was it prepared under your supervision?

A. Together with Mr. Kay, and I don't—yes, I

(Testimony of Frederick W. Files.)

don't recall whether or not we took this one to Mr. Hick's office or not. Mr. Kay and I prepared the return.

Q. I notice that that return was signed by Archie Koyl as president?

A. That is correct, sir.

Q. What, if anything, did Gene Clark have to do with the preparing of this return for the fiscal year 1949?

A. Mr. Clark had no concern with that return.

Q. He had no concern with it? A. No, sir.

Q. As a matter of fact, he wasn't with the company at that time? [169]

A. That is correct, sir.

Q. Do you know whether he was here or whether he was in Kansas? A. I don't recall.

Q. Mr. Files, with reference to the cash sales that were made out of the office, were those records that were made, were they made on regular corporation books or were they made on little scraps of paper or pads or how was that handled?

A. We just used a cheap ready form book of sales tickets consisting of an original and a duplicate and a carbon intersert and we bought at the store a dozen or so at a time. No concern was paid to numerical sequence or anything.

Q. That is all, Mr. Files.

Mr. Machtinger: Just a few questions, if I may, Mr. Files.

No. 16010

United States
Court of Appeals
for the Ninth Circuit

GENE O. CLARK and FAYE CLARK,
Petitioners,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

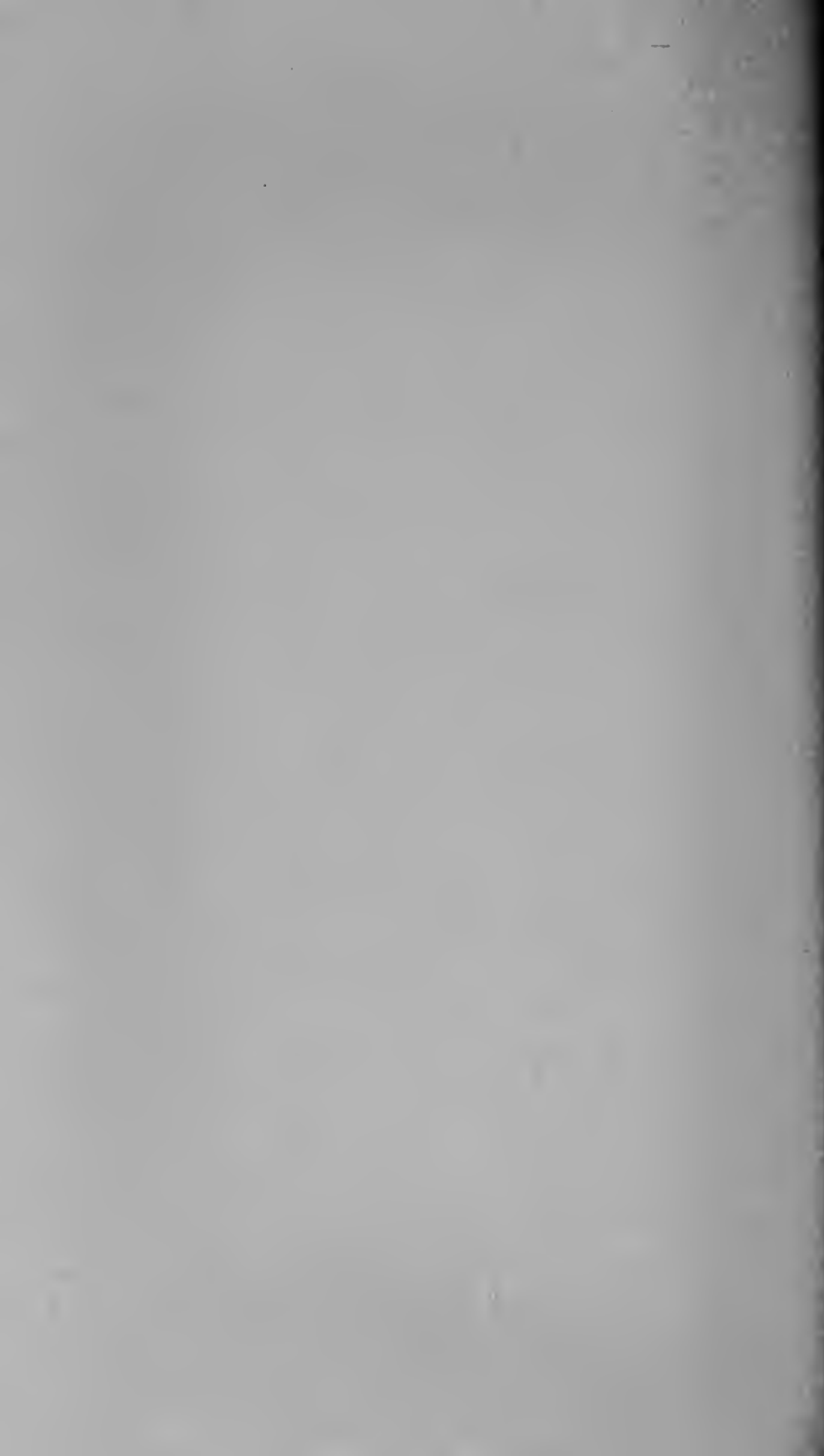
In Two Volumes
VOLUME II.
(Pages 281 to 523, inclusive)

Petition to Review a Decision of The Tax
Court of the United States

FILED

AUG 23 1958

PAUL B. BROWN, CLERK



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Petition to Review a Decision of The Tax
Court of the United States

(Testimony of Frederick W. Files.)

Redirect Examination

Q. (By Mr. Machtinger): With respect to the dividend to Mr. Clark in the sum of \$20,000 for which there is a journal entry dated April 30, 1948, was that paid to Mr. Clark by check or cash?

A. Paid to Mr. Clark with a corporation check.

Q. Did Mr. Clark ever turn back that check to you? A. No, sir.

Q. To your knowledge, did Mr. Clark deposit that check to the account of the corporation? [170]

A. No, sir.

Q. What did Mr. Clark give back to you?

A. He gave me back certain other checks totaling \$20,000 which were deposited to the account of the corporation and credited to Mr. Clark's account, notes receivable.

Q. What type of checks were included among the total of \$20,000 which you used for the entry to which I refer you?

A. I don't remember the instruments. They were substantial checks.

Q. To your knowledge, do you recall whether any of those checks consisted of checks from customers of the corporation which were made in payment of corporate goods?

A. I don't understand that.

Q. Were any of the checks that you received——

Mr. A. Baird: Just a moment, Mr. Machtinger, I don't know what you are getting at, but it seems to me that it is wholly immaterial.

(Testimony of Frederick W. Files.)

The Court: I certainly disagree with you, Mr. Baird. I think it is highly material.

Mr. A. Baird: Then I don't understand what counsel is doing.

The Court: Well, let him bring it out in his own way, unless you want him to tell the witness in advance. I think it is highly material.

Mr. Machtinger: If counsel has no objection to my [171] stating where I am going, I want to bring out that the \$20,000 dividend that was paid to Mr. Clark by check was not turned back to the corporation at all but that Mr. Clark used other proceeds which he had received and which I believe to have been proceeds from the sale of corporate goods and which he applied against this so-called \$20,000 which was turned back to the corporation.

It is my contention that there was a \$20,000 dividend, but that that dividend was not turned back.

Mr. A. Baird: Well, am I to understand that the position of the Government is that Mr. Clark did not apply the \$20,000 from some source in payment of the note, account receivable on the books of the company?

Mr. Machtinger: I would like to ask the witness questions pertaining to that fact to discover whether whether or not Mr. Clark did turn back the \$20,000 which the corporation paid to him.

Mr. A. Baird: It seems to me immaterial what \$20,000 we are talking about.

The Court: It is immaterial to what \$20,000,

(Testimony of Frederick W. Files.)

Mr. Baird, but it is very material as to whether there were two \$20,000 or one \$20,000.

Mr. A. Baird: If that is what he is trying to do, I have no objection.

The Court: I can't imagine what else he is getting [172] at.

Mr. Machtinger: That is the sole point that we are trying to prove, if we can, and if the witness has knowledge of facts of that nature.

Q. (By Mr. Machtinger): Mr. Files, you state that the corporation paid Mr. Clark \$20,000 check which represented a dividend, is that correct?

A. I believe the check was.

Q. Somewhat less, wasn't it, \$19,000—

A. \$999.82, something like that, yes, sir.

Q. Did Mr. Clark ever turn that check back to you? A. No, sir.

Q. And you testified, I believe, that Mr. Clark did turn back an equivalent in cash and other checks, is that correct?

A. I don't recall the currency or what it was composed—if I remember, it was all checks.

Q. Approximately how many checks, if you recollect?

A. I don't recollect, sir, the amount of checks.

Q. Do you recollect at all whether any of those checks represented payments by customers of the corporation for goods that those people had purchased, those customers had purchased?

A. I believe some of the names were familiar to me, regular customers of ours. [173]

(Testimony of Frederick W. Files.)

Q. Do you recall whether you applied the \$20,000 against accounts due from those customers or whether that \$20,000 was used solely with respect to the dividend entry to which we are referring?

A. The \$20,000 was credited to notes receivable, officers.

Q. Thank you, Mr. Files.

Did the corporation, to your knowledge, ever engage in the business of farming?

A. No, sir, not as such. We were on the fringes of it, but as such——

Q. Did you ever issue any checks in payment of farm expenses?

A. We maintained an account in the Citizens National Bank in Maywood under the heading Special Account No. 1, and I forget the amount involved. That particular account was used by Mr. Clark's father in Kansas to pay certain operating expenses on the farm.

Q. When you say "we maintained," are you referring to the——

A. I mean the corporation, yes.

Q. How did the corporation place funds in that account?

A. By cross deposit from our regular account.

Q. Did you maintain on your books and records as an asset—— [174]

A. Yes, sir.

Q. Did you deduct on the books and records as expenses the items, the withdrawals of funds from that account?

A. I can't recall right now, but I believe that

(Testimony of Frederick W. Files.)

that was held separately, was just for that interim period in which we didn't know whether the corporation was going to own it or whether the officers were going to own it.

Q. When you say "in the interim period" when you didn't know who was going to own it——

A. Yes, sir.

Q. Do you know who, as a matter of fact, who did own it?

A. No, I don't. I was just accounting for the money but it was turned over to Mr. Clark to purchase it.

Q. After you were advised or to your knowledge after the corporation was advised that it could not hold in its name property in Kansas, did you continue to place funds in this separate account?

A. I don't recall, Mr. Machtinger.

* * * * *

Recross Examination

Q. (By Mr. A. Baird): Mr. Files, I will ask you if the amounts to which you referred as being deposited in this special account at the [175] Citizens National Bank in Maywood wasn't approximately \$5,000?

A. You mean for Special Account No. 1?

Q. Yes.

A. I don't recall the amount. That could have been, yes, about 5, perhaps.

Q. I want to show you, this is Petitioners' Exhibit No. 19, and ask you if it isn't a fact that the

(Testimony of Frederick W. Files.)

amount so deposited was later changed back to the officers?

A. I don't know, sir. I would have to see the detail of the entries. This is just the general ledger account.

Q. I don't know whether I can get it for you or not. You can't recall? A. No, I cannot.

Q. One way or the other?

The Court: Probably has a journal reference. If you have any great reason to go into it, we have got the books here.

Q. (By Mr. A. Baird): Mr. Files, I show you the journal entry No. 20, dated 12-31-46, and ask you what that entry indicates to you?

A. The entries under the date of December 31st, 1946, there is a \$5,000 debit notes receivable and a \$5,000 credit to cash in bank reserves. The title of the journal entry or the explanation is "To transfer reserve account in the notes payable as the above reserve was loaned to Clark and Koyl for [176] maintenance of Kansas property." I believe the account here is in error, that ought to be notes receivable. I didn't make that entry, Mr. Kay made it.

Q. Does that refresh your recollection now?

A. It does, yes, I believe that is how the account was eventually closed out.

Q. So that the amounts that went into that special account ultimately came back into the corporation in the form of notes receivable?

A. Yes, sir. Well, they never were beyond—the

(Testimony of Frederick W. Files.)

amounts were an asset of the corporation, sir.

Mr. A. Baird: That is all.

Redirect Examination

Q. (By Mr. Machtinger): In connection with that entry, the entry says that the \$5,000 was loaned. Was that under the theory that the property was owned by the individuals and the corporation was merely loaning that money for the purpose of maintaining the property? A. Yes, sir.

Mr. Machtinger: That is all. [177]

* * * * *

DONALD PHILLIPS

a witness called by and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name, please.

The Witness: Donald E. Phillips. [181]

* * * * *

Direct Examination

Q. (By Mr. Gardner): Are you the same Donald Phillips that testified in the case of Archie Koyl and Fawn Koyl? A. I am.

Mr. Gardner: Inasmuch as his testimony is already in the record by stipulation, I will dispense with the preliminary questions to this witness.

Mr. T. Baird: Surely.

Q. (By Mr. Gardner): Mr. Phillips, did you examine the income tax returns of the corporation known as Gene Clark, Inc.? A. I did.

(Testimony of Donald Phillips.)

Q. Did you examine the books and records of Gene Clark, Inc.? A. I did.

Q. Did you examine the income tax returns of Gene Clark and Faye Clark? A. I did.

Q. For the years 1946, 1947, 1948 and 1949?

A. I did.

Q. Based on your examination of the books and records of the corporation, of your examination of the income tax returns [182] of the corporation, did you prepare a report recomputing the corporation income for the years involved, that would be 1946, 1947, 1948 and 1949?

A. Would you read that?

Q. The fiscal years ending April the 30th of each of those years? A. Yes, I did.

Mr. T. Baird: There was no fiscal year——

Mr. Gardner: With the exception of 1946.

Q. (By Mr. Gardner): Is this the report that you prepared, Mr. Phillips? A. Yes, sir, it is.

Mr. Gardner: Although this report has been incorporated into this case by stipulation, it probably would be well to get a number for it for identification.

Mr. T. Baird: I think we have one, Mr. Gardner.

Mr. Machtinger: I don't think so, Mr. Baird.

The Clerk: It is G in the other case, but has no number in this case.

Mr. T. Baird: If there isn't, then that's fine. I would like to have it a co-exhibit.

Mr. Gardner: All right. It is stipulated that it

(Testimony of Donald Phillips.)

will come in as Respondent's next in order and Petitioners' next in order.

The Clerk: Joint Exhibit 20-WW. [183]

(The document above referred to was marked Joint Exhibit 20-WW for identification and received in evidence.)

Mr. T. Baird: I would like the Court to understand, of course, it is for the limited purpose stated previously.

The Court: It that agreeable to you?

Mr. Gardner: Yes.

The Court: Very well.

Mr. Gardner: And also included in the stipulation, certain schedules from which he prepared the report. I would like to have these, have a separate identification——

Mr. T. Baird: Excuse me. Were these with the report we have access to or are these work papers of some kind?

Mr. Gardner: These are other work papers on which the Revenue agent's report was based.

Mr. T. Baird: I don't stipulate to those.

Mr. Gardner: Those are already in.

Mr. T. Baird: In the other case.

Mr. A. Baird: Maybe I can straighten this out. As I understand it, we had a stipulation to the effect that the testimony of the witness Phillips would be used in this case—of the witness Phillips in the Koyl case could be used in this case as though he had testified here and that all exhibits to which he referred would also come in and that we

(Testimony of Donald Phillips.)

would leave [184] it up to the Court to determine what was material to this case.

The Court: That was my understanding.

Mr. T. Baird: I'm sorry, your Honor. I did not realize that the work sheets of Mr. Phillips had been introduced in the other case.

Mr. Gardner: Is it agreeable to give this an identifying number?

Mr. T. Baird: Yes, have it a joint exhibit.

The Court: If it is going to be a joint exhibit, you might just as well mark it and put it in.

The Clerk: Joint Exhibit 21-XX admitted in evidence. Joint Exhibit 22-YY admitted in evidence. Joint Exhibit 23-ZZ admitted in evidence. Joint Exhibit 24-AAA admitted in evidence.

(The documents above referred to were marked Joint Exhibit 21-XX, 22-YY, 23-ZZ and 24-AAA for identification and received in evidence.)

Q. (By Mr. Gardner): Were the notices of deficiency issued to the petitioners in this case based on your report, Mr. Phillips?

A. So far as I know, yes.

Q. Does Schedule Q of that report show the manner of distribution of the corporation to the Petitioners? A. Yes, it does. [185]

Q. I hand you Exhibit DD. This is a check to Gene Clark, Inc. from a Southern California investment company, and I ask you whether or not that check is shown in the records of the corporation? A. This check was not.

(Testimony of Donald Phillips.)

Q. Was it recorded as a sale, Mr. Phillips?

A. No, sir, it was not.

Q. Was it deposited to the corporation bank account?

A. This check was not.

The Court: Do you have a long list of those, Mr. Gardner?

Mr. Gardner: Yes, sir.

The Court: Isn't it possible for counsel—you've got an agent to examine the books and an accountant here—isn't it possible to agree whether or not these checks were included in the records of Gene Clark or not?

Mr. T. Baird: It certainly is, your Honor.

Mr. Gardner: These items, your Honor, in connection with this item, there are several substitutions which we intend to bring out by this witness. Now, if he can just testify as to the——

The Court: Well, certainly you have a right to bring out the facts as to substitutions, but I mean, if it is going to take longer to arrange it than it is to hear it this way, then go ahead, but it does seem to me that groupings could be [186] made which counsel could stipulate and save a great deal of their time and a great deal in the record.

(Discussion between counsel.)

The Court: Gentlemen, if there is going to be an argument about it, go ahead. Proceed.

Q. (By Mr. Gardner): I hand you Exhibit EE——

Mr. A. Baird: If your Honor please, I think that we might save the Court's time if the Court

(Testimony of Donald Phillips.)

would give us above 10 or 15 minutes to confer here. Certainly there are some things about which there is no dispute; it is just a matter of reaching an agreement as to how it was handled.

The Court: Is there a disposition on the part of counsel to do this?

Mr. Gardner: Oh, no, your Honor, I am perfectly willing to stipulate anything.

The Court: You mean, "Oh, yes," I suppose, but we will take it as such. All right. I will retire and the Clerk can call me when you either have agreed to disagree or agree to agree and have determined what the terms of the agreement are.

(Recess.)

The Court: Proceed, gentlemen.

Q. (By Mr. Gardner): Mr. Phillips, you have before you Exhibits DD, EE, [187] GG, and Exhibit FF. You have previously stated that you examined the books and records of the corporation and, also, you examined the corporate returns and the individual income tax returns. Now, would you tell us just what happened to this check, according to your examination of those records?

A. This check was negotiated or cashed at Bell Gardens Bank and on the same date as the perforation date on this check, a cashier's check was issued which is Exhibit AA in the same amount.

In the records of Gene Clark, Inc. cash receipts 5491, 5492, 5493 and 5494, in the respective amounts of \$1,786.16, \$1,473.93, \$1,250 and \$2,099.91, were recorded as being received respectively from Gene

(Testimony of Donald Phillips.)

Clark, Story and Sons, Las Vegas Supply Company and Las Vegas Supply Company. The cashier's check was deposited in the Citizens National Bank, Maywood Branch, and included in a deposit dated March 31st, 1948, in the amount of \$12,816.85, and, included in my schedule of cash receipts unidentified as opposed to deposit items unidentified. That is where I have it located.

Q. What was the total amount of those cash receipts, Mr. Phillips? A. \$6,610.

Q. Did you discover that they were deposited?

A. The cash, only the cashier's check was the item of deposit. [188]

Q. Were any of the amounts shown on the cash receipts deposited?

A. Not as individual items, no, sir.

Q. How did the corporation report its income, Mr. Phillips? From deposits and cash receipts?

A. Well, their sales record is the record of income.

Q. You stated that the check in the amount of \$6,670 did not get into that record?

A. That's right, sir.

Mr. Gardner: May I have Exhibits LL and MM, please?

The Clerk: Those are the two checks, aren't they?

Mr. Gardner: Would you mark this for identification Respondent's next in order?

The Clerk: Is this one exhibit?

(Testimony of Donald Phillips.)

Mr. Gardner: Both of them, yes.

The Clerk: Respondent's Exhibit BBB marked for identification.

(The document above referred to was marked Respondent's Exhibit BBB for identification.)

Mr. T. Baird: We will stipulate to those.

Mr. Gardner: It is stipulated, if it please the Court, that Exhibits LL and MM, two checks, were not included in the records of Gene Clark, Inc., neither as a deposit or as a cash receipt, and also not included in the income. It is [189] also stipulated that—now, follow this closely—that a cash payment of \$12,000 testified to previously by Mr. Meissenburg was not included or not shown on the records of the corporation and was not included in income for the corporation.

Mr. T. Baird: That is correct.

The Court: All right, then, do you contend that either of the items just discussed were included in the personal income tax returns of Gene O. Clark and his wife?

Mr. T. Baird: I do not contend that, no, your Honor.

The Court: All right. If we are going to get into that, we might just as well know it while we are having these stipulations. Let's find out whether there is any such contention.

Mr. Gardner: That would be—will you stipulate to that, that it was not included?

The Court: He has already so stipulated.

Mr. T. Baird: I might add, your Honor, just so

(Testimony of Donald Phillips.)

the record will show that we are not admitting by that stipulation that that is the income to the taxpayers, but it may have been return of capital.

The Court: We are not admitting that it is capital. You are admitting that it was not included in income.

Mr. T. Baird: Yes, your Honor.

Mr. Gardner: Will you stipulate that the checks [190] entered in evidence, that is, from the Valley City Supply, were not shown on the books and records of the corporation?

(Discussion between counsel.)

Mr. Gardner: It is stipulated that the checks included in Exhibit AA are not included in income of the corporation and not shown on the books and records of the corporation.

The Court: It is further stipulated that they were not included in the income tax returns of the Petitioners?

Mr. T. Baird: It is, your Honor, with the same reservation.

The Court: Very well. I understand to each of these items that you are not admitting they are income.

Mr. T. Baird: That is correct.

Mr. Gardner: Will you stipulate——

(Discussion between counsel.)

Mr. T. Baird: So stipulated, Mr. Gardner.

Mr. Gardner: And this check?

(Discussion between counsel.)

Mr. T. Baird: So the record will show all of

(Testimony of Donald Phillips.)

these stipulations should read the same. I don't think we need to state it each time, your Honor, do we?

The Court: I don't see any need as long as it is identical with preceding ones. If there are any variations, you can bring them up. Otherwise, you can simply identify the items and say stipulated the same as previous items. [191]

Mr. Gardner: Exhibit CC, a check in the amount of \$2,294.50, payable to Gene Clark, from Mitchel & Son. It is stipulated that this amount was not shown on the books and records of the corporation, was not included as income for the corporation, and was not shown as income on the individual income tax returns.

Mr. T. Baird: So stipulated as before.

Mr. Gardner: Exhibit TT, a check in the amount of \$2,223, payable to Gene Clark Plumbing Company, same as the prior stipulation.

Mr. T. Baird: Agreed.

Mr. Gardner: May I have Exhibit SS, please?

The Clerk: Here it is.

Mr. Gardner: The same?

Mr. T. Baird: The same.

Mr. Gardner: Stipulated that Exhibit S, a check in the amount of \$1,158.44, the same conditions existing as to this check as in the preceding exhibits.

May I have Exhibits U, V and W, please?

Q. (By Mr. Gardner): Mr. Phillips, I hand you Exhibits V, U and X, and ask whether or not those

(Testimony of Donald Phillips.)

checks were recorded in sales for the corporation?

A. Exhibit U, a check, No. 15340, Hamilton Homes, Inc., was not recorded in sales or in cash receipts of Gene Clark, Inc., [192] but was included in the bank deposit of Gene Clark, Inc., dated September 16, 1947, in the amount of \$21,180.51. That check was in the amount of \$1,221.

Exhibit W, a check in the amount of \$2,295, No. 15390, Hamilton Homes, Inc., further, was not included in the sales record nor in the cash receipts records as such, but was deposited in the same deposit.

Check No.—Exhibit V, check No. 14760, Hamilton Homes, Inc., account in the amount of \$2,170 was not included in the sales records of Gene Clark, Inc., nor identified in cash receipts as such, but was in the Gene Clark, Inc. deposit dated July 30, 1947, in the amount of \$10,016.46.

Exhibit X, checks dated September 15, 1947, in the amount of \$1,000, and September 23rd, 1947, in the amount of \$224, drawn on the account of H. K. Niles, for \$1,000 was not included in the sales reported, nor was it identified as such in the cash receipts record, but was included in the September 16, 1947, deposit in the amount of \$21,180.51 of Gene Clark, Inc.

Q. As to the check for \$224, Mr. Phillips, I believe you will find that check was recorded.

Mr. T. Baird: I beg your pardon?

Mr. Gardner: The check in the amount of \$224 was recorded.

(Testimony of Donald Phillips.)

Mr. T. Baird: Are you willing to so stipulate?

Mr. Gardner: Yes, we will so stipulate.

Q. (By Mr. Gardner): I hand you Exhibit II, a cash receipt received from Gene Clark, \$8,241.42. In accordance with your investigation, did you discover any connection between this receipt and those checks that you recently referred to?

A. The cash receipt which reveals that an amount of \$8,241.42 was received from Gene Clark as an individual by Gene Clark Plumbing Company, although this was a regular cash receipt used by Gene Clark, Inc. In my schedule of substituted items, page 4 of nine, for the year ended April 30, 1948, reveals that within the deposit, dated September 16, 1947, in the amount of \$21,180.51, that a check in the amount of \$3,241.42, as a result of my investigation, was determined to have been drawn against the Gene Clark Plumbing account in the Bank of America, El Monte, was included in this deposit and, also, items as follows: Drawn on the California Bank, Bell office, Bell, a check in the amount of \$178.70; a check on the California Bank, Bell Office, Bell, in the amount of \$48.43. In the previous exhibits referred to of \$1,000 from H. K. Niles on his check No. 68, \$1,221 from the Hamilton Homes, check No. 1534 and \$2,295 from the Hamilton Homes, check No. 1539.

Q. Am I to understand, then, that the checks that you just now referred to were substituted for \$5,000 that Mr. Clark did not pay to the corporation

(Testimony of Donald Phillips.)

in connection with the [194] cash receipts in the amounts of——

Mr. T. Baird: Objected to as asking for a conclusion of the witness.

The Court: It isn't really a conclusion. What have you got to say about it?

Mr. Gardner: Well, the witness has testified that he did discover a check from Gene Clark Plumbing in the amount of \$3,241.42, leaving \$5,000 still to be accounted for, and he has testified that included in the deposit with these checks totaling approximately \$4,516.

I am asking him now if that was the result of a substitution.

Mr. T. Baird: Your Honor, I think the record speaks for itself, that he does not have to draw this conclusion. You can pick checks out of the air and say these were all substitutions for this one item.

Mr. Gardner: I am asking in accordance with the investigation.

The Court: Mr. Gardner, it seems to me that this witness was asked to determine a final analysis from circumstances. He has testified to all of the circumstances and I rather fancy that the final analysis has got to be made by me. I don't think it is too significant at this point because I think the analysis is perfectly clear, but there may be some objection to this witness theoretically taking my prerogative, [195] so I think I will sustain the objection as to the final question.

(Testimony of Donald Phillips.)

Mr. Gardner: I had no intention, your Honor, of usurping the Court's—

The Court: I am sure you didn't. You can ask him—he is here with his records and his calculations—you can ask him what he did and in connection with the calculation rather than the fact, as to what he concluded, which is something I will ultimately have to agree with or disagree with, so I will permit you to ask him. After all, he is testifying as to various calculations he made with respect to adjustments, and the Revenue agent's report, the statutory notice of deficiency in relation to the return on the books, and I will let him answer as to what he attributed it to for the purpose of the calculation.

Q. (By Mr. Gardner): For the purpose of your calculation, Mr. Phillips, what significance did you attach to the checks, three checks, previously mentioned, which I believe you testified were deposited but were not reported as a cash receipt?

Mr. T. Baird: Objected to for the same reason, your Honor.

The Court: I am going to overrule the objection. Answer the question. It is understood that I am amending the question with the modification that I made before, whether it [196] is clear or not, so answer the question.

The Witness: I added the checks into my exhibit for the fiscal year ended April 30, 1948 as unreported income determined from substituted items in

(Testimony of Donald Phillips.)

bank deposits. That exhibit is Exhibit J in my report.

The Court: All right, go ahead.

Q. (By Mr. Gardner): Mr. Phillips, in examining the books and records of the corporation, did you discover, during the year 1946, on or about February 5th of that year, a payment for income from one Y. L. Creed in the amount of approximately \$2,350.

A. Mr. Gardner, there were no records of the corporation prior to May 1st, 1946.

Q. Did you examine the records of the partnership for that time prior to the formation——

The Court: Better call it Clark Plumbing Company so that we don't get into an argument as to whether it was a partnership or not.

Mr. Gardner: Yes, your Honor.

Q. (By Mr. Gardner): ——Clark Plumbing Company prior to the formation?

The Court: Gene Clark Plumbing, I'm sorry.

Q. (By Mr. Gardner): Gene Clark Plumbing.

A. What was the amount? [197]

Q. It is approximately \$2,350.

A. Of unreported income from what customer?

Q. Y. L. Creed.

A. My only recollection of the item is the fact that \$544 was deposited to the account of Gene Clark Plumbing on February 5, 1946 and was reported in sales of that organization or company.

The Court: Does that mean that you found no

(Testimony of Donald Phillips.)

entry with respect to the difference between the two amounts?

The Witness: My report had an amount of \$3,602.50 of contract work performed for Y. L. Creed by Gene Clark on which Gene Clark was allowed the difference as a down payment on a house from Y. L. Creed.

The Court: All right.

Q. (By Mr. Gardner): Was the amount allowed as a down payment on a house from Y. L. Creed reported as income by Mr. Clark on his individual income tax return? A. No, sir.

Q. Did it show on the records of the Gene Clark Plumbing Company? A. No, sir.

Mr. Gardner: No further questions.

Cross Examination

[198]

Q. (By Mr. T. Baird): Mr. Phillips, speaking of the Y. L. Creed transaction, will you state over again to me how you treated that transaction in your report?

A. The total amount of \$3,602.50 plumbing contracts for work performed on four houses for Y. L. Creed, only an amount of \$544 was deposited to the account of Gene Clark Plumbing on February 5th, 1946 and was reported in the prior organization's sales. The remainder was allowed as a credit outside escrow and I added it to income of the corporation.

Q. Income of whom or what?

A. It is Gene Clark, Inc.

(Testimony of Donald Phillips.)

Q. Why Gene Clark, Inc.?

A. I believe the transaction of the sale of the house was after incorporation.

Q. Didn't you realize that all of the transactions occurred prior to incorporation?

A. I don't believe they did. If they did, then I must have made an error in my report.

Q. Well, did you adjust the cost basis later on in your report when Mr. Clark sold the house, Mr. Phillips?

A. I don't—

Q. 1947, to be exact, when he sold the house?

A. I don't know offhand if he reported a gain or not, but if he reported no gain, I didn't do anything because the loss would have not been deductible. [199]

Q. He reported a gain. It is on his tax return, Mr. Phillips. Did you increase his basis?

A. I do not know, sir. I would have to see the report.

Mr. T. Baird: May I have the tax return for 1947, Gene Clark?

While we are looking for this, Mr. Phillips, will you look at your report and show where you adjusted the basis, if you did, in 1947?

* * * * *

The Witness: Thank you.

Would this be the sale of the residence in June of 1947?

Q. (By Mr. T. Baird): Yes, it would.

A. From my report, it appears that I allowed \$708.50 of cost outside of escrow. To the best of my

(Testimony of Donald Phillips.)

recollection, the reason that I allowed no more was that of the \$8,500 cost basis claimed, all that I was able to substantiate would have been [200] the difference between—that was paid out of costs outside of escrow, would have been the difference between the \$3,058.50, which I added to income in the Gene Clark, Inc. case and the \$708.50 which I allowed here.

Q. You mean to say, Mr. Phillips, that you allowed the same figure that you used as a fictitious profit to Mr. Clark in 1946, you carried on through to raise his basis when he sold it in 1947?

A. Mr. Baird, I said that he claimed a cost basis of \$8,500.

* * * * *

The Witness: The cost basis claimed on this home was \$8,500 in the return, evidently. All that I could verify as having been paid through escrow was an amount less than \$8,500 and, therefore, instead of allowing the entire \$3,058, which I had added in the Gene Clark, Inc. case, I only allowed \$708.50, and used the remainder of that figure, or approximately \$2,300, as being part of the cost basis of \$8,500 which he claimed.

Q. (By Mr. T. Baird): So you added more into income in the Gene Clark income in the fiscal year '47 than you added to the base?

A. No, sir. [201]

The Court: That is not what I understood him to say.

(Testimony of Donald Phillips.)

Mr. T. Baird: I am sorry, your Honor. I am not getting——

The Court: If I can try to explain it my way, let the witness correct me if I am wrong, he says that the taxpayer used a basis which he couldn't verify and to the extent that he couldn't verify it he supplied it in part with some of this \$3,000 odd dollars, bringing it up to the basis that the taxpayer did claim, to which he added \$700-some dollars that he hadn't exhausted in the process.

Now, is that correct or not?

The Witness: That is correct.

The Court: So, according to his testimony, he allowed the full amount to increase the base after first having reduced the base by an amount which he couldn't verify.

Q. (By Mr. T. Baird): Did you ever consult Mr. Gene Clark about the base to see if you could get any verification?

A. I never talked to Gene Clark during the entire course of my investigation.

Q. I would like to refer you now, Mr. Phillips, to Exhibit Q of your report. Reading down Exhibit Q to sub E thereof, I see—have you got that so far? I don't want to go ahead.

A. All right. [202]

Q. You have that entitled Total Distributions Per RAR, \$74,984.96. Then, reading over to the right under Gene Clark, you have the years 1946 and 1947, and you, apparently, have broken up the amounts of \$74,984.96 into two amounts and you

(Testimony of Donald Phillips.)

have allocated one amount to 1946 and another to 1947. Will you tell the Court how you arrived at that allocation for each year?

A. As far as I can remember at this time, it was based upon the stock ownership of 30-70, and for each year on the amounts available to be applied as constructive dividends.

Q. Well, how did you know what the amount available for 1946 was? How did you arrive at the figure \$44,237.13?

A. I don't seem to have the computation here of how that is done, sir, but this point has been belabored so much that all I can say is that I did it on a stock ownership basis and I do not recall at this time.

Q. Well, I realize that you attributed 70 per cent of the profits to Mr. Clark and 30 per cent to Mr. Koyl. That has been already gone into, but I am asking you, this first year, you realize, do you not, that the fiscal year ended April 30, 1947?

A. I do, sir.

Q. Well, how could you have had any amount available for distribution in 1946 when the taxpayers were on a calendar year basis? [203]

A. Well, if this had been a partnership, I would believe that when the period ended that this would be when I would have distributed it, but it was a corporation, and the moneys were taken outside the records of the corporation and, therefore, I distributed them as they got them, on a cash basis to the

(Testimony of Donald Phillips.)

individuals, as they got them or as they were made available to them.

Q. Then you can show me that \$44,227.13 was either received or made available to them in 1946?

A. Only that it was available to them.

Q. How?

A. By the computation of the adjustments to net income in my report, plus the Kansas farms, and less the accounting adjustments to net income I made that I said were not available.

Q. We will go on now, Mr. Phillips. I believe that you testified in prior testimony, which is a part of this record, that you took income taxes or income taxes and corporation taxes in this case into consideration when you reached a figure of total distribution. Where on Schedule Q can you show me that income taxes was taken into consideration?

A. We would have to go to one of the other exhibits, Exhibit D, analysis of surplus.

Q. What page is that, Mr. Phillips, and will you show there the amount of income taxes that you took into consideration? [204]

A. \$43,885.88.

Q. Well, Mr. Phillips, look to Schedule 1 of your report, statements of total tax liability. Haven't you got down there total income tax liability is \$50,419.26?

A. I do, sir.

Q. Well, how do you account for the difference?

A. At this time, I can't, sir.

Q. All right, well, let's go on, let's go back to Schedule Q. To recapitulate, your Schedule Q does

(Testimony of Donald Phillips.)

not take income taxes into account at all, is that correct, Mr. Phillips?

A. No, sir, but only in amount available from the adjustments in my report.

Q. You have stated in previous testimony that you made certain adjustments to the amount that is available for distribution. I am now referring to Schedule Q and also your explanation on Schedule Q-1. Are those the adjustments that you took into consideration? A. Yes, sir.

Q. In determining distributable net income for the fiscal year 1947? A. Yes, sir.

Q. Let's refer back to your Schedule D on page 58, Mr. Phillips. Where on that schedule can you show me that those items shown on Q-1 of your report and on Schedule Q of your report were taken into consideration in analysis of surplus on [205] Schedule D, other than merchandise purchases? A. They aren't, sir.

Q. Why not?

A. I don't think that it is necessary.

Q. Didn't you just state that you made certain adjustments to arrive at income available for distribution? A. Yes, sir.

Q. And now you are saying that you didn't think it was necessary when you made up this exhibit?

A. This is a statement of the surplus account as such. The additions for the year were \$132,000, and out of the \$132,000, after taking away the \$74,000 and, in this case, \$43,000 income taxes and \$2,700

(Testimony of Donald Phillips.)

of merchandise purchases, there is still a remainder of \$11,000 surplus, \$11,097.01 of earned surplus still available.

Q. In other words, you didn't take them into consideration in final analysis, is that correct? On Q-1, you said you were taking them into consideration, did you not? I refer to D on Schedule Q-1. You state adjustments to net income not available, \$63,488.47.

A. Oh, possibly the wording is not correct, but that was used as a reduction from the total amount of the constructive dividends.

Q. Do you really believe that was used as a reduction and carried through to the 90-day letter, Mr. Phillips? [206]

A. Yes, sir.

Q. You believe that \$63,000 was subtracted from the \$102,000?

A. I didn't say that it was subtracted from \$102,000.

Q. Well, I am referring now back to Schedule Q.

A. I said that it was a reduction of the amount on Schedule Q, arrived at by using the adjustments to net income and the items A, B, and C, other investments, notes receivable, a total of \$138,473.43.

The Court: Mr. Baird, at this point we will recess until five after four.

(Short recess.)

Q. (By Mr. T. Baird): Mr. Phillips, did you prepare balance sheets for each of the years involved for this corporation?

(Testimony of Donald Phillips.)

A. You mean amended balance sheets to conform with my report?

Q. Yes. A. No, sir.

Q. Why didn't you?

A. I was not required to by my findings.

Q. Well, if you had, would you not have taken into consideration the items listed in Schedule Q and Q-1 in arriving at adjusted figure as to what was available for distribution, a figure somewhat less than on Exhibit D of your report? [207]

A. No, sir.

Q. You wouldn't? How would you have treated it in your balance sheet, those items in Exhibit Q-1 if you had prepared one? You know what items I am referring to?

A. Not offhand now, I don't know what you are referring to.

Q. I am referring to the items Truman Johnson, H. L. Brittain, deferred income, bad debts, and an item you have marked "All Items with Exception of \$200 Check to Archie Koyl," \$2,714. Do you see where I am reading?

A. Yes, you better rephrase it or go over it again, I am sorry.

Q. If you had made a balance sheet, would you have treated those items in that balance sheet as not being available for distribution? Would you have reduced your surplus by those amounts?

A. No, sir, I would not.

Q. Why?

A. They are not adjustments to the surplus

(Testimony of Donald Phillips.)

account itself. The adjustments to the surplus account are made on Schedule D.

Q. Wouldn't you have set up a reserve on the liability side of your balance sheet for these items?

A. Well, for example, deferred income item is a reserve on the books. [208]

Q. And in the fiscal year 1947, if that is a reserve on the liability side of the balance sheet, then it is not available for distribution, is it?

A. In my report, I reversed that. On a balance sheet, it would no longer have been a reserve.

Q. Don't you set that aside in Exhibit Q as a reserve?

A. I only used it as a reduction for the amount available for dividends.

Q. You did that on Exhibit Q but did you do that on Exhibit D?

A. No, sir, as I explained, sir, that is no entry in the surplus account as such and the Exhibit D is only the surplus account as amended.

Q. Well, let's get away from Exhibit D, then. Let's talk in general. Referring to the 90-day letter, and it has been stipulated that the 90-day letter is based on the Revenue Agent's report, have you looked at the 90-day letter, Mr. Phillips?

A. Just, oh, cursory examination.

Q. Have you had any time to look at it?

A. Yes.

Q. Do you believe that this account in Q-1 that we have been talking about has been taken into account when arriving at that figure in the 90-day

(Testimony of Donald Phillips.)

letter? A. Yes, sir, I do believe so. [209]

Mr. Gardner: May I inquire, are we talking about the corporate 90-day letter or the individual?

Mr. T. Baird: One is dependent upon the other, Mr. Gardner. I will include both of them in that statement.

Q. (By Mr. T. Baird): Well, going ahead, Exhibit Q, you treated the amount \$49,210.15, the deferred income item, as not available for distribution on Exhibit Q and Q-1. Isn't that what you have entitled it? A. Yes, sir, that is true.

Q. Well, what did you do with that item? Did you use it as an item available for distribution in any year?

A. As I mentioned, I only used it as a limitation, an item that I reduced the total amount available for dividend distribution.

Q. In what year?

A. The year ended April 30, 1947.

Q. You say that you reduced the amount available for distribution by \$49,210? A. Yes, sir.

Q. Did the corporation report this item as income in the year 1948, in the fiscal year 1948?

A. Well, not that item as such, but by—

Q. By total amount?

A. Method of income reporting that they were using, that [210] amount came into income in the following year, the subsequent year ended April 30, 1948.

Q. What year did you treat the \$49,000 deferred income item as available for distribution?

(Testimony of Donald Phillips.)

A. In the following year, when I used it to increase. It is included in the adjustments to net income, really.

Q. And then, it was, as far as you can see now, from your schedule, it was not taken into consideration in 1947 as reduction of surplus available in '47, is that correct?

A. It is not a reduction of surplus available but only a reduction of the figure that I used of \$138,000 of moneys available, moneys or properties or other things available for distribution.

Q. Did you know, Mr. Phillips, that figure \$49,000 and all the rest of the figures therein were in fact used twice as income available for distribution? What I mean by that, in the year 1947 and in the year 1948, the same items and, as reflected in the 90-day letters which are based on the Revenue Agent's report. Did you know that fact?

A. I do not know it now, sir.

Mr. T. Baird: That is all.

The Court: I am sorry, you said something I couldn't hear.

Mr. T. Baird: That is all.

The Court: Very well. [211]

* * * * *

Q. (By Mr. T. Baird): Did you attempt to make any net worth—take a net worth statement or a calculation of Gene Clark or Faye Clark?

A. Do you mean at any time during the investigation?

Q. Yes.

(Testimony of Donald Phillips.)

A. I believe at some time during the investigation we attempted to make up some net worth sheets, balance sheets.

Q. Have you those sheets with you?

A. No, sir.

Q. Are they available?

A. They were never a part of my work papers as such.

Q. Well, as a result of your attempts, what conclusions did you arrive at in regard to the net worth of these petitioners?

A. You just want an opinion?

Q. Yes.

A. That during some of the years, that he had far greater increases than his net worth, than he had reported on his tax return. [212]

Q. Well, did you specifically trace any of these items to Mr. Clark's individual bank account?

A. The unreported items of income of the corporation?

Q. That are included in your report on the corporation.

A. Well, to the Gene Clark Plumbing account and the Bank of America——

Q. Well, aside from Gene Clark, Inc. and Gene Clark Plumbing, any other bank accounts?

A. I didn't personally trace them. I had the records of some of the bank accounts in Independence, Kansas where some of the unreported items finally had gone to.

(Testimony of Donald Phillips.)

Q. Those banks accounts being set up for the farm proposition back there?

A. I don't know why they were set up, sir.

Q. Did you trace any of these moneys to Mr. Gene Clark directly or his wife or for their enjoinderment?

A. I can't remember any specific ones, but I am sure that there were some that they received. [213]

* * * * *

GENE O. CLARK

was called as a witness by and on behalf of the petitioners and, having been first duly sworn, was examined and testified as follows:

* * * * *

Direct Examination

Q. (By Mr. A. Baird): Mr. Clark, will you state where you were born, please?

A. At Independence, Kansas.

Q. And will you tell us, please, by way of introduction, something about your educational experience? [215]

A. Yes, I had two years of high school.

Q. And that was at what place?

A. At Independence, Kansas.

Q. You graduated from high school about when?

A. I did not graduate, I had two years.

Q. I mean the two years. You terminated your association with high school, shall we say?

A. About '27.

Q. After leaving high school, Mr. Clark, in what occupation or business did you engage?

(Testimony of Gene O. Clark.)

A. Quite a lot of different things. I worked for the Perry Pipeline Company, Sears Roebuck, and numerous odd jobs around a small town, and then I went into the plumbing business.

Q. Had your father before you been engaged in the plumbing business?

A. Yes, Dad was a plumber before I was born and still is.

Q. And he still resides where?

A. At Elk City, Kansas.

Q. You say that you went into the plumbing business. Did you go into the plumbing business in Kansas?

A. No, sir, I went into the plumbing business in Maywood, California.

Q. What time? A. 1939.

Q. 1939? [216] A. '39.

Q. Was it necessary for you to apply for and obtain a license or permit to work as a plumber in California at that time?

A. Yes, it is necessary to pass a master's plumbing license in order to contract and, of course, that's what I did. That is, in fact, running a business, and I passed that examination.

Q. And have you held that license under the State of California ever since?

A. Yes, in numerous cities.

Q. In other words, it is necessary to get licenses in the various cities as well as have a State license?

A. That is correct.

(Testimony of Gene O. Clark.)

Q. How long did you operate your plumbing establishment in Maywood, California?

A. I was only there a short time, some few months, and we moved to a larger and better location at Huntington Park.

Q. And how long did you engage in the plumbing business at that place?

A. We ran a plumbing shop there up and until some time in '41, and it ran, I think, even into '42, even though I was, myself, personally at Las Vegas.

Q. In 1941 and just prior to the time that you went to Las Vegas, how large an operation did you have? [217]

A. I was of the opinion we ran 50 some-odd men, but some of my employees tell me we ran a little more than that because of the floor furnaces or the heating crews, so I would say it varies between 50 and 75 men.

Q. Then, as I understand you, in 1941, you left and went to Las Vegas, Nevada?

A. That's correct.

Q. And did you continue your business here in Los Angeles County?

A. Yes, I left the foreman in charge to finish up all of our contracts here and as he finished them, then he could bring the crews and trucks and et cetera up to Las Vegas.

Q. Now, what particular type of plumbing business did you engage in?

A. I have always did contracting plumbing, that

(Testimony of Gene O. Clark.)

is to say, we take a contract to do a job at a given price.

Q. As a part of your operation, were you engaged in the business of selling plumbing supplies and materials? Was that a main part of your operation?

A. It was never our main part, no, sir.

Q. Now, what type of business did you engage in when you went to Las Vegas?

A. At Las Vegas, I did plumbing contracting. As a matter of fact, I had a contract of some 74 houses to start on which was one reason of going there. Almost immediately upon [218] my arrival, I built a building, and we also opened the Nevada Plumbing Supply, that is plumbing supplies wholesale, sales to the plumbers. Then, I, unfortunately, posted a bond for a contractor and it appeared at the first of the job as though he couldn't or wouldn't complete it, so I automatically went into the general contracting business.

Q. Well, Mr. Clark, you said that you posted a bond. What was the nature of the bond and what was the amount?

A. A Mr. Ralph Saunders had signed a contract—

* * * * *

The Witness: Mr. Saunders couldn't post a bond, which was some \$189,000, so they called me in primarily to post the bond and be the general contractor, which I did.

Q. (By Mr. A. Baird): You put up a bond—you

(Testimony of Gene O. Clark.)

were required to put up a bond for what amount?

A. I believe it was \$189,000.

Q. Did you complete that contract?

A. Yes, sir.

Q. How long did you remain in Las Vegas?

A. A little over a year. [219]

Q. Then what did you do?

A. We went to Provo, Utah and did a housing job for the Geneva Steel employees, that is I did it for Dr. Shipley Nelson of 92 houses.

Q. 92 houses? A. Yes, sir.

Q. During any of this period of time to which you have referred, were you associated with Archie Koyl? A. No, sir.

Q. After you had completed your contracting work in Provo, Utah, you returned to California, did you not? A. That's correct.

Q. Will you tell us about when that occurred?

A. It was in the latter part of '43 or the first of '44.

Q. And under what name or designation did you operate in California?

A. Gene Clark Plumbing.

Q. And at that time, in 1944, were you the sole owner of Gene Clark Plumbing? A. Yes, sir.

Q. At some point at or about that time or shortly thereafter, you entered into some sort of an arrangement with one Archie Koyl, did you not?

A. That's correct.

Q. Can you tell us about when that occurred?

A. It was in 1944, I believe, at the latter part.

(Testimony of Gene O. Clark.)

Q. The latter part of 1944? A. Yes, sir.

Q. Now, before I get into that, may I ask you, when you came from Utah, did you bring with you any plumbing supplies, materials, or things of that kind? A. Not when I came from Utah.

Q. Well, what disposition, if any, did you make of supplies that you may have had when you left Las Vegas?

A. I liquidated or turned into cash most of the assets that I had, which included the plumbing shop, trucks, tools and equipment, the Nevada Plumbing Supply, a building, and lots, and construction equipment, et cetera. I turned most of that to cash.

Q. You stated that you formed some sort of a business arrangement with Archie Koyl. Can you tell us how that occurred and what the arrangement was?

A. Yes, one of the boys from Las Vegas, one of the plumbers and I were doing a very nice business. As a matter of fact, it was growing so rapidly that we needed help tremendously, and Archie had from time to time asked me if I knew where he could get into a business rather than work for a larger company, and I think one day we were doing something and he said what would it take to get in the plumbing business with you, and I said, "Well, just how much do you want? How much do you have?" [221] and he said, "\$1,500," and I said, "I tell you what, I will give

(Testimony of Gene O. Clark.)

you 30 per cent of the profits or a salary and we will just do it."

Q. Was Mr. Koyl a licensed plumber?

A. No, sir.

Q. Had he ever had any experience, to your knowledge, in the plumbing business?

A. I doubt it.

Q. Well, had you known Mr. Koyl prior to this meeting that you are telling us about?

A. Yes, we went to school together through the first grade.

Q. Back in Kansas? A. That's correct.

Q. I take it then that you have been intermittently in contact with one another, favorably and otherwise, ever since you left the first grade down to the present time? A. That's correct.

Q. Can you fix the date as near as you can—I think it is in the records, but just for my own information—as to when Mr. Koyl came with you and when you started this business arrangement to which you have just referred?

Well, Mr. Clark, it isn't necessary to be precise about it. I am just trying to be——

A. I had believed it to be about October, 1944.

Q. What did you have Mr. Koyl do when he became associated with you?

A. Well, he, naturally, didn't know plumbing supplies and, actually, what I needed was somebody to do the purchasing which—it is a very tedious job and takes a lot of time. That is, at that time you needed to drive a truck all day and

(Testimony of Gene O. Clark.)

pick up what you could where you could, so I attempted to show him the difference between pipes and fittings and so forth. So, I went with him for some weeks and finally, of course, he learned to do his own purchasing or recognize what he needed to buy, and after that time he did most all of the purchasing for both the plumbing and the corporation, the Gene Clark Plumbing and the Gene Clark, Inc.

Q. What was the particular type of plumbing business that you were doing at that time? Were you still contracting or were you engaged in distributing plumbing supplies?

A. We were doing mostly contracting but quite a lot of heating at that time.

Q. Quite a lot of heating? A. Yes, sir.

Q. I assume you mean by that you were installing furnaces? A. Yes, sir.

Q. Equipment of that kind?

A. That's correct. [223]

Q. And was that installation for private homes or industrial buildings or what?

A. Private homes.

Q. Coming down to some time in the early part of 1946, Mr. Koyl was still with you. Did you determine to make a change in your mode of operation?

A. Yes, we had decided to form a corporation. That was early in '46.

Q. And that corporation was actually incorpo-

(Testimony of Gene O. Clark.)

rated on or about the 1st of May, 1946, was it not?

A. That's correct.

Q. At the time that you formed this corporation, how large an establishment did you have? How many plumbers did you have working for you? What volume of business were you doing?

A. At the time the corporation was formed, we were running both El Monte and Bell Gardens. I would judge possible 35 plumbers.

Q. That's in both shops? A. Yes, sir.

Q. Can you give any estimate from your experience in this business, Mr. Clark, as to how much of an investment you need to run a shop of that size where you have 30 or 35 plumbers?

A. Yes. At this time of 1946?

Q. Yes. [224]

* * * * *

The Witness: Under the circumstances, at the time we believed that in order to run a shop and pay the bills promptly, we believed it should be variable from \$4,500 to \$5,000 per man.

Q. (By Mr. A. Baird): When you formed this corporation, the record shows that it was incorporated for some \$50,200. That is correct, is it not?

A. That's correct.

Q. What went to make up the \$50,200 worth of capital that went into that corporation?

A. Well, number one, Mr. Cloud, the attorney, informed us that we should make available assets for this amount. So we knew, of course, we needed all of the trucks and we needed the pipe machines

(Testimony of Gene O. Clark.)

and the necessary things to run the shop, so we made an itemized list of those. Then, of course, the balance that was left, we made up of plumbing supplies as an inventory.

Q. Well, did you have any excess of plumbing supplies, inventories, material, and so forth, on hand on May 1st over and above the amount that was placed into the inventory of the [225] new corporation, Gene Clark, Inc.? A. We did.

Q. You did. Can you give us any estimate as to how much of an inventory you had or, may I ask, do you have any record of the amount of inventory? A. I do not have a record.

Q. Did you have any record?

A. I did have a record.

Q. Well, is it available now?

A. It is not.

Q. What happened to it?

A. That record, as well as my other personal records in 1948 or the first part of 1949, a Mr. Earl Stutzman of the Internal Revenue came out to El Monte and requested to check my returns for the years of 1946, '7, and '8. He approached Mr. Koyl first and finally Mr. Koyl brought him to me, and he requested to check these returns and I, of course, asked him to come in and we'd give him the necessary records that he asked for.

He came to the shop and I don't think on that trip we did too much. However, for several trips later, I took records as he would request them, which was my tax returns and paid bills and so

(Testimony of Gene O. Clark.)

forth, and I took them to his house. When he finished checking me, which was some 90 days later and I had at that time left the corporation and I was actually waiting to go to [226] Kansas, but I stayed 90 days waiting for him to finish my book work, and when he finished it I promptly left the next morning for Kansas. So, naturally, I didn't get any of the records back, and at this time I don't know where they are. [227]

* * * * *

Q. (By Mr. A. Baird): Mr. Clark, going back to the time that Mr. Stutzman first called upon you, will you tell me, please, what he asked of you in the way of records or data or information?

A. Yes, he asked for all of my personal records for the years of '46, '7 and '8.

Q. Was his interrogation or investigation limited to you individually or did it involve Gene Clark, Inc., as well?

A. It was me individually. [229]

* * * * *

Q. (By Mr. A. Baird): Mr. Clark, I will ask you whether or not he didn't indicate to you that his investigation was prompted by some informant's report? A. That's correct.

Q. Did you give him at that time the records that you had then available and for which he made a request? A. Yes.

Mr. Machtinger: Would you identify what records, now? Are these still personal records?

(Testimony of Gene O. Clark.)

Mr. A. Baird: Personal records, all personal records. [230]

Q. (By Mr. A. Baird): Then, as I understand you, from time to time he would make inquiry for something else, and you furnished that?

A. Yes, sir.

Q. Getting back now to the time of your—immediately preceding the incorporation of Gene Clark, Inc., you operated under the term of Gene Clark Plumbing, did you not? A. Yes, sir.

Q. Had you filed any certificate for doing business under a fictitious name or had you filed any partnership certificate showing that Mr. Koyl had any interest in this business? A. No, sir.

Q. Did you have any difficulty or any unpleasantness, disputes or controversies with Mr. Koyl with reference to the percentage and distribution of profits of this enterprise?

A. Not at that time.

Q. Well, leading up to the time of the corporation, forming of the corporation, had there been any discussions and any arguments as to the handling of funds or the distribution of profits?

A. Yes.

Q. Had Mr. Koyl made any statements to you that he was dissatisfied with the arrangement and wanted a larger percentage?

A. Yes, he felt he should have 50 per cent. [231]

Q. As a matter of fact, Mr. Clark, isn't it true that on your 1946 and your 1945 income tax returns that you reported a distribution of profits showing

(Testimony of Gene O. Clark.)

that you got 50 per cent and that Mr. Koyl got 50 per cent? A. Yes, sir.

Q. However, when you formed the corporation, what percentage arrangement did you finally agree upon? A. 70-30.

Q. And you obtained 70 per cent of the stock and he obtained 30 per cent of the stock?

A. That's correct.

Q. It is true, is it not, that on your individual returns which are in evidence for the year 1945 or for the year 1946 in particular, that you reported a certain amount of income from Gene Clark, Inc. and a substantial amount of income from another business which I assume was Gene Clark Plumbing? A. That's correct.

Q. Did the fact that you were having some difficulty with Mr. Koyl have anything to do with your determination to form a corporation?

A. Yes, it did.

Q. Did you have any consultation with your lawyer, Mr. Cloud, about that? A. Yes, sir.

Q. Had you ever been engaged before in business under a [232] corporate form, Mr. Clark?

A. No, sir.

Q. This is the only corporation experience, then, that you have had, as I understand it?

A. That's right.

Q. Will you tell us generally what the conditions were with reference to the availability of materials and supplies for the carrying on of the

(Testimony of Gene O. Clark.)

contracting plumbing business during the years 1945, '46, and well, let's say, '47?

A. It was very hard to obtain materials.

Q. And were there some Governmental restrictions on the amount of materials that you could obtain and the prices that you could pay?

A. There was, of course, price control.

Q. By that, do you mean priorities, or do you mean OPA?

A. There was both.

Q. Mr. Clark, will you state whether or not you found it necessary in order to continue with your business to make some deals with people from whom you sought to obtain supplies wherein you were required to pay cash?

A. There was many of that type of deals.

Q. And would those deals entail a situation where a regulation price was billed to your company and then an additional amount was paid in cash?

A. Yes, sir. [233]

Q. There has been some testimony here to the effect that a rather substantial amount of transactions of that kind occurred between your company and some concern down in Tyler, Texas. Will you tell us, please, when you first started doing business with this concern at Tyler, Texas and what was the name of that firm?

A. That is the Tyler Foundries at Tyler, Texas.

Q. Tyler Foundries?

A. Yes, sir.

Q. Who was the president and principal executive officer with whom you had your dealings?

(Testimony of Gene O. Clark.)

A. I am not sure, but I did business with Mike Harvey or a Mr. Heller, his assistant.

Q. You don't know whether he was the president or what, but he was the man with whom you dealt?

A. Yes, sir.

Q. Were your deals there rather extensive or somewhat—were your dealings there rather extensive or somewhat limited?

A. They were rather extensive.

Q. And did they cover the period 1945, '6, '7, maybe later?

A. Well, they covered '46, '7, and into '48.

Q. Why was it necessary for you to go way down to Tyler, Texas in order to get material?

A. That was the only foundry that we found in the United [234] States where we could buy materials.

Q. What particular type of plumbing material were you getting from that foundry?

A. Principally soil pipe.

Q. Principally soil pipe?

A. Yes, sir.

Q. And can you tell us what the arrangement was that you worked out with the gentlemen at Tyler, Texas?

A. Yes. If he sold us a carload of soil pipe, we, in turn, would pay \$300 in addition to his bill of lading in cash—or \$3,000.

Q. \$3,000?

A. Yes, sir.

Q. And how did that \$3,000 compare to the regulation price for which he billed your company?

A. Very close to double.

(Testimony of Gene O. Clark.)

Q. If I understand you correctly, if the quantity of soil pipe that you were obtaining in a particular transaction was billed to your company at \$3,000, are we to understand that you would pay an additional \$3,000 cash? A. Yes, sir.

Q. Did the amount of cash that you had to pay in these transactions vary from time to time?

A. I believe they were all the same. [235]

* * * * *

Q. Do you have any record or did you have any record of the amount of cash payments that you made in these transactions that you had with this concern down at Tyler, Texas?

A. I had a record.

Q. Do you have that record now?

A. No, sir.

Q. Well, is that one of the records which you—to which you have referred in the Stutzman situation? A. Yes, sir.

Q. Can you give us any estimate, Mr. Clark, as to the amount of cash which you paid with reference to these [236] transactions involving Mr. Heller or Mr. Mike Harvey of Tyler, Texas?

A. I believe it to be variable between \$25,000 and \$30,000.

Q. That was cash that was paid for material which your company was purchasing in addition to the invoice price for which you were billed?

A. That's correct.

Q. Do you know whether or not Mr. Files, your office manager and the controller, and later, treas-

(Testimony of Gene O. Clark.)

urer, knew of the amount of cash that you were paying on these transactions or made any record of that in his books?

A. I am sure he didn't make a record in his books and I rather doubt that he knew any amounts.

Q. You heard his testimony this morning that he was generally familiar with the fact that this procedure was being carried on? A. Yes, sir.

Q. Mr. Clark, will you please tell the Court from what source did you get the money to make these cash payments to which you have referred and if there was more than one source we want to know that.

A. The source was by making sales of materials for cash or for checks and turning them to cash. That is the only source. [237]

Q. You have heard the testimony of Mr. Files in the Koyl case and in your own case this morning to the effect that you would sometimes come to him with checks and ask him to cash those checks and he would cash them out of the amount of money in the safe or in the cashbox or wherever you kept it in your office. A. That's correct.

Q. His statement in that regard is substantially correct? A. Yes, sir.

Q. And will you state whether or not that was one of the sources of money? A. Yes, sir.

Q. Which you used to make the payments to the people down in Texas? A. Yes, sir.

Q. You heard, did you not, Mr. Files' statement that there was no record made on the books

(Testimony of Gene O. Clark.)

of the company of these cash payments made for materials which your company had to have?

A. Yes, I did.

Q. And I take it that you are in agreement with his statement in that regard? A. I am.

* * * * * [238]

Q. Directing your attention to the very beginning of the corporation, will you state for the information of the [239] Court whether or not you made any segregation of inventory and supplies as between the corporation on the one hand and the Gene Clark Plumbing on the other?

A. Originally, I separated them.

Q. And will you tell us what you mean by separating them? Did you have them in different yards or were they all in the same yard, same place, or what?

A. No, sir, the inventory I set aside for the corporation was in the Bell Gardens shop only. We set it aside to see if we could run the Bell Gardens shop on that inventory. The thing happened that you would expect and I expected it, the plumbers simply get in either part.

Q. I didn't quite hear.

A. The plumbers use out of either side, so actually the inventory got intermingled.

Q. Well, it is true, is it not, in the relatively short space of time the inventories were intermingled so there was no physical separation?

A. That's correct.

Q. Mr. Clark, in connection with the business

(Testimony of Gene O. Clark.)

that Gene Clark Plumbing was doing during the period after the corporation had been formed, did Gene Clark Plumbing as such have a license to operate as a plumbing contractor? A. No, sir.

Q. What had happened to Gene Clark Plumbing license? [240]

A. That license was, of course, taken into the corporation so that the corporation would have a license to do contracting.

Q. Are we to understand that the license is transferable?

A. To a corporation if the licensee is an officer.

Q. That is if an officer of the corporation is a licensee of the State? A. That's correct.

Q. Were you the only officer who could qualify in that respect? A. That's right.

Q. Koyl had no license? A. That's right.

Q. Now, then, did Gene Clark Plumbing then engage in contracting without any license?

A. No, sir.

Q. Did it do any contracting? A. No, sir.

Q. Did you do anything which you attributed to Gene Clark Plumbing other than to sell some material or trade some materials?

A. Nothing at all.

Q. Keeping in mind the period of time and your statement that materials were very scarce and hard to get, I will ask you whether or not it was necessary on more or less frequent [241] occasions for you to engage in trading and bartering with other plumbing concerns in order to obtain from them

(Testimony of Gene O. Clark.)

certain parts or material which they had which you needed in exchange for some different parts or material which you had and which they wanted?

A. I did some and Mr. Koyl did more, I believe, than I did.

Q. Do you know whether or not those transactions where there was simply a trading of materials of one kind for materials of another, were those transactions recorded on the books, or do you know? I am not sure that you know.

Mr. Machtinger: Would the reporter please read that question?

(Question read.)

The Witness: I don't believe they would be.

Q. (By Mr. A. Baird): Mr. Clark, did you pay any particular attention to the matter of book-keeping for auditing your concern?

A. No, sir.

Q. Have you had any experience or do you know anything about the matter of keeping books and auditing the books of the concern?

A. No, sir.

Q. Do you leave that more or less entirely to your auditor, Mr. Files? A. Yes, sir. [242]

Q. Mr. Clark, there has been some testimony here—well, I will withdraw that.

Before I forget it, my questioning with reference to cash payments to which you have referred has been more or less limited to transactions down in Texas. I would like to ask you whether or not your company engaged in somewhat similar trans-

(Testimony of Gene O. Clark.)

actions with other concerns elsewhere in the country? A. Yes, sir.

Q. And did you engage in any such similar arrangements with any concerns in Los Angeles?

A. Yes, sir.

Q. You have heard some testimony here with reference to some sort of an arrangement that was worked out between Gene Clark, Inc. and the Keenan Pipe and Supply, I believe it was. Are you familiar with that transaction?

A. No, sir, Archie did that.

Q. Archie Koyl worked that out?

A. Yes, sir.

Q. Well, did you have any particular knowledge at the time that there was some sort of an arrangement for transactions in cash only between your company and the Keenan Pipe and Supply?

A. I didn't know it was cash only.

Q. There has been some testimony here by a plumbing contractor by the name of Lloyd—

The Court: Before you get into that, I would like to [243] understand his last answer. It was a little bit cryptic to me. He didn't know it was cash only. Well, what did you know about it?

The Witness: Well, I was of the opinion that there was trading with them. I remember one trade of some trucks for materials.

The Court: Well, didn't you know there were substantial transactions involving purchases from Keenan?

The Witness: No, sir.

(Testimony of Gene O. Clark.)

The Court: Do you know whether or not there was any question of getting a discount of one-third by paying cash to Keenan?

The Witness: Did you say whether there was a question?

The Court: I say do you know anything about it?

The Witness: No, sir.

The Court: You never heard of anything like that until you heard Mr. Koyl testify to it, is that your statement?

The Witness: No, I have heard it before.

The Court: Well, when did you first hear about it?

The Witness: Possibly two years ago on a trip out here.

The Court: And never until then?

The Witness: No, sir.

The Court: Well, where is Keenan located?

The Witness: They are off Santa Fe Avenue. It is in [244] Los Angeles City, about 30th Street or 34th.

The Court: All right, go ahead.

Q. (By Mr. A. Baird): Mr. Clark, there has been some testimony here by a plumbing contractor by the name of Lloyd Meissenburg. Mr. Meissenburg testified that he purchased or arranged to purchase or did purchase a quantity of material consisting of some 8, 9, or 10 truckloads, and that in making the payment for that material you came to his office and he paid you \$12,000 in cash in addition to

(Testimony of Gene O. Clark.)

some further payment by check which was made either then or later. You heard that testimony this morning? A. Yes, sir.

Q. Is that testimony correct?

A. Yes, sir.

Q. Mr. Meissenburg gave you the \$12,000 at that time? A. Yes, sir.

Q. And what did you do with it?

A. Took it back to the shop.

Q. What did you do with it then?

A. Paid Archie.

Q. You paid Archie? A. Yes, sir.

Q. What do you mean when you say you paid Archie? Will you elaborate on that a little?

A. That was at that time when I was buying all of [245] Archie's stock.

Q. That was some time about February, 1948?

A. Yes, sir.

Q. And you say that was at the time you were buying all of Archie's stock?

A. Yes, sir.

Q. Where did you make this payment to Archie?

A. At the shop.

Q. And was that in part payment of his interest in Gene Clark Plumbing or in Gene Clark, Inc.?

A. In Gene Clark Plumbing.

Q. With reference to the balance of that transaction that was paid in by check as I remember it, do you know what was done with the check?

A. Yes, sir.

Q. What happened to that?

(Testimony of Gene O. Clark.)

A. I deposited it in Gene Clark Plumbing account in El Monte Bank of America.

Q. You did not deposit it in the Gene Clark, Inc. account? A. No, sir.

Q. What did you do with the funds—well, I will withdraw that, Mr. Clark. I am not sure that is material. Until I know, I will withdraw the question.

The Court: You are not going to get away from that [246] \$10,000 without having him explain what, if anything, he did about it, are you? The \$10,000 cash.

Mr. A. Baird: You are referring to the \$12,000, your Honor.

The Court: \$12,000, I am sorry, yes.

Mr. A. Baird: He has stated.

The Court: Well, he stated he paid the money to Archie, yes, but he hasn't stated whether it went on the books of the corporation or didn't go on it or whether he included it in his income tax return or not or in the corporation income tax return or not. He stated everything that gets down to the point of where it makes a difference and I'd like to hear the rest of it.

Mr. A. Baird: Very well.

Q. (By Mr. A. Baird): Will you state whether or not this \$12,000 which you received from Mr. Meissenburg was reported in the bank account or on the books of Gene Clark, Inc.?

A. No, sir.

Q. Do you know whether or not it was reported

(Testimony of Gene O. Clark.)

as an income item for materials sold on your individual return? A. It was not.

Q. Will you state to the Court whether or not these particular materials were materials which you in your own mind identified or considered to be materials of Gene Clark Plumbing [247] as distinguished from Gene Clark, Inc.?

A. That is the way we considered it.

The Court: Well, it is a pretty leading question, Mr. Baird, especially when this witness just got finished testifying that he paid the money over to Archie for Archie's interest in Gene Clark Plumbing.

Mr. A. Baird: Well, I think I can see how your Honor might draw an inference from that, but as I understand the situation he was in the process of liquidating whatever he could and making a settlement with Archie Koyl. Now, this was one, as I understand it, kind of transactions that were entered into in getting money into the hands of Archie Koyl.

The Court: Well, he took \$12,000 which he didn't report and which he didn't count—account for and turned it over to Archie Koyl, according to his statement, for something. Was it either Archie Koyl's interest in the Gene Clark Plumbing Company or an indebtedness or an obligation or a trade or something of that kind? I am not clear as to what it was yet.

Mr. A. Baird: I am not sure that the witness can make it any more clear because we have labored under difficulties of that kind for some time.

(Testimony of Gene O. Clark.)

The Court: Let him make one more try, Mr. Baird.

Mr. A. Baird: Very well.

The Court: What were you going to get for the \$12,000 which you turned over, you say, to Archie? What were you going [248] to get for it?

The Witness: Nothing.

The Court: You mean you were giving it to him?

The Witness: No, sir, it was a part of his payment for that part of the plumbing materials owned by Gene Clark Plumbing.

The Court: Well, then, you were paying something that was owed to him, is that correct?

The Witness: Yes, sir.

Mr. A. Baird: Is your Honor through?

The Court: I suppose so.

Q. (By Mr. A. Baird): Mr. Clark, as I understand it, this \$12,000 was a part of a rather substantial amount which was involved in this transaction. In other words, Mr. Meissenburg, in addition to the \$12,000 to which you have referred, also had given you a check for \$3,074.74, which has been introduced here as Respondent's Exhibit LL, and on February 9th, 1948, had given you a check for \$22,935, with a notation on it "Material in Full" and which has been introduced as Respondent's Exhibit MM.

Will you tell us what you did with those checks?

A. I deposited those in the Bank of America at El Monte.

(Testimony of Gene O. Clark.)

The Court: Well, let me try once more here. I still don't understand this \$12,000 item. You testified that when Archie came along with you, he had \$1,500. [249]

The Witness: Yes, sir.

The Court: So, unless it was added on later, he didn't have very much capital?

The Witness: Yes, sir.

The Court: You were the one that had the capital. Then you testified that while in the beginning you only took over part of the materials, inventory of Gene Clark Plumbing, that sooner or later they got mingled, but in the meantime Archie had an interest in Gene Clark, Inc., too?

The Witness: Yes, sir.

The Court: Now why did you have to pay Archie \$12,000?

The Witness: Well, in the starting of the Gene Clark Plumbing, he let all of his commissions stay in the company. He brought in additional materials that he was credited with, and this was a balance of all that he had put into the Gene Clark Plumbing.

The Court: So you were using this money to pay out his share, is that it?

The Witness: Yes, sir.

The Court: Well, who is this share going to belong to? Did it belong to the corporation or to you or what?

The Witness: No, sir, belong to Archie.

The Court: Well, yes, but you paid him \$12,000

(Testimony of Gene O. Clark.)

for that. Who got it? Who got the share? [250]

The Witness: That wasn't in the corporation, sir.

Mr. A. Baird: It was a liquidation of the material, your Honor.

The Court: Well, does he mean that he liquidated the material himself and was paying Archie's share to him or what?

Mr. A. Baird: Well, I would say that, drawing what seems to be a reasonable inference from the figures involved, the amount of the two checks, \$22,935 and the other check of \$3,074.74 which the witness says that he put in his own bank account, is that happens to be roughly, I am told by Mr. Claypoole, 70 per cent of the total, so that the \$12,000 would represent roughly, not to the precise penny, but roughly, 30 per cent.

The Court: In other words, they were splitting the Meissenburg money 70-30, and Archie got his in the \$12,000 cash and Mr. Clark got his through the checks?

Mr. A. Baird: I would say that is a reasonable inference from documentary facts that we have.

The Court: All right, I think we might well recess at this time. [251]

* * * * *

[Endorsed]: Filed April 25, 1955.

[Title of Tax Court and Dockets Nos. 48542-3-4.]

Los Angeles, California, April 1, 1955

9:30 O'Clock A.M.

PROCEEDINGS

GENE O. CLARK

was recalled by and on behalf of the petitioners, and having been previously duly sworn, was examined and testified further as follows:

Direct Examination—(Continued)

Q. (By Mr. A. Baird): I want to direct your attention to certain purchases of certain farm property down in Kansas, and will you tell the Court briefly what, if any, plans the Gene Clark, Inc. had with reference to acquiring of farm property in Kansas?

A. Yes, sir, I made a trip to Kansas to look over property.

Q. Can you tell us approximately when that was?

A. In 1946.

Q. In 1946. Very well.

A. And I looked at property that I thought would be good, and I came back and we decided that it would be well if the corporation bought. So I went back to Kansas and started making arrangements to purchase. When I found that the corporation in Kansas could not own or operate a farm, I came back and notified the corporation; and since I felt it was quite a good buy, I made arrangement to go ahead and purchase this farm myself. [255]

(Testimony of Gene O. Clark.)

Q. And that is commonly referred to in our discussions as the north farm? A. Yes, sir.

Q. May we have that map here?

* * * * *

Q. (By Mr. A. Baird): Now, what arrangements did you make with your corporation in regard to obtaining money for the purchase of this farm?

A. I believe I borrowed \$10,000 from the Valley City Supply for a part of the down payment, and I borrowed some from the corporation, of which I proposed to give the corporation [256] a note for. I think, at that time, we proposed that the corporation would operate this farm, though, not own it, but operate it.

Then, on another trip back to Kansas, I found that they couldn't own or operate, so then I took over the operation as an individual.

Q. And at or about that time, did you have some discussion or controversy with Archie Koyl relative to the manner in which the title to this farm had been taken? A. No, sir.

Q. Well, you heard Mr. Koyl's testimony, did you not? I believe he testified here to the effect that you had taken title to a piece of property in your name and he wasn't very happy about that.

Mr. Machtinger: Objection. Mr. Koyl has not testified in this proceeding and that is testimony in another procedure. I think counsel, for the record, should state the question specifically and not refer to outside testimony in another proceeding.

(Testimony of Gene O. Clark.)

Mr. A. Baird: It is a matter of no consequence. I will withdraw it.

Q. (By Mr. A. Baird): Mr. Clark, I will ask you to state whether or not it is true that pursuant to some discussion that you had had with Archie Koyl, that it was decided that another farm would be [257] acquired in Kansas in Archie Koyl's name? A. That is correct.

Q. And that was done, was it not?

A. That is correct.

Q. And that is referred to on the map, Petitioners' Exhibit 25, as the South Farm, is it?

A. That's correct.

Q. And I notice on this exhibit there is also a farm designated as the Gene Clark West Farm, the Buffalo Ranch. A. Yes, sir.

Q. That was something you acquired when?

A. I believe I bought that in 1948.

Q. That Buffalo Ranch has nothing to do with the transactions between you and Archie Koyl?

A. No, sir.

Mr. A. Baird: Now, at this time, Mr. Machtinger, we would like to offer in evidence, to make the record complete, a photostat of the minutes of the board of directors, dated September 16, 1946, and July 22, 1946, and March 10, 1948. We have given you copies of these.

Mr. Machtinger: Respondent has no objection to the admission of these documents subject to our right to examine the original and for the pur-

(Testimony of Gene O. Clark.)

pose of checking whether or not they conform to the original minutes. * * * * [258]

Q. (By Mr. A. Baird): Now, there has been introduced in evidence as Petitioners' Exhibit 19, a ledger sheet, and I desire to direct your attention, ask you to look at account No. 10 of the general ledger, the date of 1947, and particularly to the item of \$27,518.99, and ask you to state whether or not that represented a note receivable from you to the corporation? A. It did.

Q. And can you state whether or not that \$27,518.99 indebtedness there to the corporation arose by reason of your acquisition of the farm property in Kansas to which you have referred?

A. That's correct.

Q. Now, at the time, Mr. Clark, that you acquired the stock of Archie Koyl, did you enter into an agreement with him indicating and specifying what the consideration was that you were to pay him for the stock?

Perhaps my question isn't well put. I will withdraw it.

I show you this photostat of an agreement dated the [259] 28th day of January, 1949, and direct your attention to the signatures on the signature page, and ask you if those are the signatures of Archie Koyl, Fawn A. Koyl, and Gene O. Clark?

A. They are.

Q. My associate corrects me. This agreement is in 1949 and it relates to your sale of your stock to Mr. Koyl. A. That is correct.

(Testimony of Gene O. Clark.)

Q. Is that right? A. That's correct.

Mr. A. Baird: We would like to offer this in evidence, Mr. Machtinger.

Mr. Machtinger: If the Court please, I have seen this photostat during the course of this trial. I have not seen the original; there has been no explanation as to where the original is. I think that question is important since on page 3 of this photostat, paragraph 8, there is written through that paragraph the word "void" with certain other words that are not readily legible. It is that paragraph which goes to the \$27,000 item which counsel is now questioning the witness about. There has been no explanation as to whether this document is offered with this paragraph considered excluded; there is no explanation as to where the original is, whether original had any delineations through it, and because there has been no proper foundation laid for the introduction of this photostat, I must object on that basis. [260]

* * * * *

Q. (By Mr. A. Baird): Mr. Clark, directing your attention to paragraph 8, which reads: "Koyls hereby agree that they will assume the payments to Gene Clark, Inc. of \$27,518.99, now owed by Clark to the corporation, and will supply a trust deed to secure the payments thereof," naming Gene Clark, Inc. beneficiary on property owned by Koyls at 6833 Eastern Avenue, Bell Gardens, [261] California. Koyls further agreed that they will cause the corporation to release the trust deed now on

(Testimony of Gene O. Clark.)

the books of the corporation, securing the payment of said amount by Clark to the corporation.

I will ask you now, you will notice that, written across that paragraph 8 are the words "void, see attached sale affirmation." Now, I will ask you to state to the Court whether or not these words written across that paragraph 8 were on there at the time that you signed this agreement?

A. They were not, because that was certainly my opinion at the time of this agreement.

Q. Do you know who wrote that writing, "void, see attached sale affirmation"?

A. I do not.

* * * * * [262]

Mr. Machtinger: I will withdraw my objection as to Petitioners' Exhibit 27 as long as it is stipulated by counsel that the original from which this copy was made is in all respects identical with this copy and includes thereon the word "void," through paragraph 8.

Mr. T. Baird: I will swear to that under oath. I will so stipulate.

Mr. Machtinger: Thank you.

The Court: All right. It will be received.

* * * * *

Q. (By Mr. A. Baird): Mr. Clark, Exhibit 27 which is the agreement that you executed on the 28th of January, 1949, when you sold out to Archie Koyl, contains, among other things, the agreement on the part of Archie Koyl that he would assume your liability to the corporation for the amount of \$27,518.99?

A. That's correct. [264]

(Testimony of Gene O. Clark.)

Q. Was there ever any change in that agreement? A. No, sir.

Q. I notice by referring to Petitioners' Exhibit 19 that the general ledger account No. 110, has the title "Notes Receivable, Officers," which has been stricken out and above that is written "Trust Deeds." Do you know who altered the heading of that record? A. No, sir.

Q. Was that alteration done pursuant to your direction? A. I don't believe it was.

Q. Did the corporation ever own any trust deeds? A. No, sir.

Q. Did either you or Archie Koyl ever give the corporation trust deeds as security for the obligations which you owed the corporation?

A. No, sir.

Q. I will ask you to state whether or not that was contemplated at one time?

A. Not at any time.

Q. Well, let me refresh your recollection. Referring now to the agreement, Petitioners' Exhibit 27, there is some reference here in the paragraph 8 about which you have been talking that the Koyls further agree that they will cause the corporation to release the trust deed now on the books of the corporation securing the payment of said amount by Clark to the corporation. Had you ever given the corporation a trust deed to secure that \$27,518.99? A. No, sir.

Q. Had Archie ever given the corporation a trust deed to secure his obligation?

(Testimony of Gene O. Clark.)

A. He was supposed to on the Bell Gardens property.

Q. That is correct. He was supposed to, but did he? A. I don't know, sir.

Q. You don't know.

The Court: Before you get from the farm subject, there are one or two facts that are no doubt clear to you, but not clear to me. You must remember, these details come to me out of the blue and if you were about to pass on it, I would either like to ask the witness a few questions or get some information. [266]

* * * * *

The Court: You, in mentioning how you got the money to pay for the farm, you said you borrowed part of the money from the corporation, and you said you borrowed part of the money from some other organization, the first name of which was Valley; Valley what?

The Witness: Valley City Supply.

The Court: Valley City Supply. Now, what do you mean by borrowing the money from them? Was it a direct loan from them to you?

The Witness: Yes, sir.

The Court: This was not a question of taking some amount of cash or check from Valley and using it and obligating yourself to Gene Clark, Inc.?

The Witness: No, sir. I borrowed \$10,000 and I

(Testimony of Gene O. Clark.)

paid him back very promptly. It was just a matter of days.

The Court: Well, what was the amount of cash that you said you borrowed from Gene Clark, Inc.?

The Witness: The farm cost \$40,000 and I got a [267] mortgage from the bank for \$18,500, and the balance I put ten that I borrowed from Valley City, and whatever the balance would be I borrowed from the corporation.

The Court: You seem to be, in your testimony, that balance you did name an amount before, I thought of around \$10,000. I may be mistaken, but it differed very widely from the \$27,000 indebtedness shown on the books. Now, I would be glad to have that explained for completeness.

Mr. A. Baird: Well, if your Honor please, perhaps I can explain that in this way: By reference to Petitioners' Exhibit 19, and the ledger account, it will be observed that the indebtedness of Clark and Koyl at one time was Clark, \$25,000, Koyl, \$10,844.79, and that is as of the date of March 31, 1948, or rather, April 30, 1948. The indebtedness on the part of Mr. Clark of \$47,518.99 has been reduced by the application of \$20,000, which Mr. Clark has testified was the difference which he had received from the corporation.

Now, there is one further link in it which helps clarify the matter perhaps and that is at the time that Mr. Koyl sold out to Mr. Clark, there was an agreement and we have that, whereby Mr. Clark agreed to—— * * * * * [268]

(Testimony of Gene O. Clark.)

(The document above referred to heretofore marked Petitioners' Exhibit No. 29 for identification was received in evidence.)

Mr. A. Baird: This is dated the 29th day of March, 1948, and it indicates that Mr. Clark had agreed to assume the liability for the \$10,844.79, which Mr. Koyl owed the corporation. He also agreed to assume on accounts receivable \$1,540.13, as indicated by the Exhibit 29.

The Court: All I want to get clear in my head, the witness has kept talking about the entire \$27,000 as being attributed to the farm arrangement. I gather now that it is the result of a number of things that happened, including what you have just described, and that the amount he borrowed from the corporation is what he originally testified he borrowed in relation to the farm? [269]

Mr. A. Baird: I think it is true, and I believe there is no dispute about it, that the \$27,000 item is the end result of a number of transactions, which in the main, center around these farm deals.

* * * * *

Q. Mr. Clark, in 1948, or perhaps before, you can correct me on the date if I am wrong, I will ask you to state whether or not you employed a firm of accountants in Independence, Kansas, for the purpose of doing whatever auditing was necessary, keeping whatever records were necessary in connection with your farm operation? A. I did.

Q. And can you give us the name of that firm of accountants?

(Testimony of Gene O. Clark.)

A. That is Joseph Acre, A-c-r-e, certified public accountants.

Q. And do you know when they first began doing work for you?

A. Yes, sir. I saw Joseph Acre when I first bought the farm, because I wouldn't be there and I wanted him to keep, help Dad keep it straight.

Q. Well, can you tell us now, was that in 1947 or '48? A. That was in '46.

Q. Oh, in '46? A. Yes, sir.

Q. Now, did he make out your income tax returns for 1946 and 1947? A. No, sir.

Q. Who made out your individual income tax return?

A. Either Mr. Files or whomever he might have had do it.

* * * * *

Q. (By Mr. A. Baird): Now, Mr. Clark, the returns for the year 1947 — and I show you Joint Exhibit 6-F, have no indication on the return [271] as to whom it was prepared by. Do you know who prepared that return?

A. I believe Freddy Files.

Q. Was that prepared on or about the last day of the filing period?

A. It was the last day. [272]

* * * * *

Cross Examination

Q. (By Mr. Machtinger): Mr. Clark, you testified with respect to the inventory of the Gene Clark Plumbing organization on or about May 1,

(Testimony of Gene O. Clark.)

'46, when the corporation was formed, that there were actually two separate inventories; is that correct? A. That is correct.

Q. Where were those inventories physically located?

A. In both El Monte and Bell Gardens shops.

Q. There were not, then, ever inventories located in any other place than those two shops?

A. No, sir.

Q. With respect to the inventory that was allegedly not belonging to the corporation, was that held for the purpose of sale? A. No, sir.

Q. What did you hold it for?

A. For the purpose of—for the plumbers to use.

Q. Which plumbers? Those belonging to the corporation?

A. That is all there were; yes, sir.

Q. Although it was held for the purpose of use by the [277] corporation, are you testifying that it was not corporation property?

A. That is correct.

Q. What procedure did you use for accounting between the corporation and anyone who might have loaned this other inventory?

A. I'm not quite sure I know what you mean by "accounting".

Q. Did the corporation ever account to you, did it ever pay you for this inventory which it was using that supposedly did not belong to the corporation? A. No, sir.

(Testimony of Gene O. Clark.)

Q. Were you giving it as a gift to the corporation?
A. No, sir.

Q. I don't understand with respect to this point: You say the corporation did not pay you for the inventory which it took from this separate pile or this segregated inventory which did not belong to the corporation, is that correct?

A. That is correct.

Q. And the corporation never placed on its books as purchases this property from any other source, referring to this specific inventory? Did it record it as a gift to the corporation?

A. No, sir.

Q. It recorded it as a purchase from you? [278]

A. No, sir.

Q. In other words, the corporation used it, and never picked it up in its own inventory, is that right?
A. That is correct.

Q. Now, with respect to the record-keeping of this separate inventory, how did you view the corporation's acquisition of such inventory? Did you make any accounting for your own purposes?

A. Only in dollars and cents.

Q. For what purpose did you make that accounting?

A. So when or if we could dispose of it, or if the corporation, when or if they didn't need it any more, we could get an equal amount back.

Q. Who is the "we" to which you are referring?

A. Archie Koyl and myself.

(Testimony of Gene O. Clark.)

Q. Did both of you own this separate inventory?

A. Yes, sir.

Q. And what percentage of ownership did you have in that inventory? Did you each own 50 percent of it?

A. No, sir.

Q. What percentage did you have?

A. I don't know. That is a definite percentage, or that it wasn't a definite percentage; it was a matter of how much he had contributed and how much I did.

Q. Well, how much did you consider that you had [279] contributed to it and how much did you consider Mr. Koysl had contributed to it?

A. I think—Of course, I had more than Koysl, but I believe Koysl had somewhere around 30 percent in it.

Q. At what time did his inventory accumulate?

A. This inventory accumulated back before Koysl came there, partially.

Q. This inventory accumulated during the time when you were operating the Gene Clark Plumbing Company?

A. That is correct.

Q. Did the inventory belong to the Gene Clark Plumbing Company?

A. Yes, it did.

Q. It belonged to you and Mr. Koysl as owners of the Gene Clark Plumbing Company, is that correct?

A. That's correct.

Q. Did you take an inventory on or about May 1, 1946, when the Gene Clark organization incorporated?

A. Yes, sir.

Q. Was that taken by the old organization?

(Testimony of Gene O. Clark.)

A. Gene Clark Plumbing, you mean?

Q. Well, strike that question.

Who took the inventory?

A. Archie and myself.

Q. Was anyone else present when you took the inventory? [280]

A. They were probably present.

Q. Did you take an inventory of all the stock and assets of the organization? A. Yes, sir.

Q. Did the Gene Clark Plumbing Company, prior to incorporation, maintain books and records?

A. Yes, sir.

Q. To the best of your knowledge, were those books and records accurate? A. No, sir.

Q. To what extent were they not accurate?

A. We never did keep an accurate record; that is to say, on the books of the entire inventory.

Q. You say the entire inventory did belong to the Gene Clark Plumbing Company prior to incorporation? A. That is correct.

Q. Why didn't you keep an accurate record of inventory?

A. Because we used so much of it for the purposes of selling to obtain cash to buy above ceiling prices and on priorities that if we had it in our inventory, we would have automatically been halted from buying these additional materials.

Q. When you took your inventory on or about May 1, 1946, you say you took an inventory of the entire stock of the corporation, or that organization; is that correct?

(Testimony of Gene O. Clark.)

A. Of the Gene Clark Plumbing. [281]

Q. Did the Gene Clark Plumbing Company's books reflect the true inventory as of May 1, 1946?

A. No, sir.

Q. Was anyone other than you acquainted with what that true inventory was? A. Yes, sir.

Q. Who else would have known that?

A. Mr. Koyl.

Q. When you took the inventory on May 1, 1946, did you physically segregate the inventory which allegedly did not belong to the corporation?

A. We did.

Q. Why did you make that segregation?

A. Actually, we were going to try to separate it and keep it straight that way, but there wasn't enough inventory that we could put into the corporation to let them operate, hence, it was impossible.

Q. How soon after May 1, 1946, were the two inventories mingled, commingled?

A. Very promptly.

Q. Let's say three months after May 1, 1946; would it have been possible for anyone to go into your yards and both shops and determine whether there was any inventory there that did not belong to the corporation?

A. It would have been impossible. [282]

Q. How could you tell at that time what belonged to the corporation and what belonged to any other party?

A. Actually, an inventory you couldn't, only in dollars and cents.

(Testimony of Gene O. Clark.)

Q. What do you mean you could tell in "dollars and cents"?

A. If you took an inventory, deducted that which we had in it, the balance is the corporation's.

Q. Did the corporation purchase any stock after May 1, 1946? Did the corporation make any purchases after May 1, 1946? I assume it did.

A. Material?

Q. Material. A. Yes, sir.

Q. And those materials were placed together with the other inventory that you then had?

A. That is correct.

Q. There was no way you could tell what belonged to the corporation and what may have belonged to someone else, is that correct?

A. Not as materials, you couldn't tell.

Q. Did you ever buy materials—strike that question.

Did the Gene Clark Plumbing Company, other than the organization, exist after the date at which the corporation was formed? [283]

A. Yes, sir.

Q. What was the function of the Gene Clark Plumbing Company after the corporation was formed?

A. Only in the purchasing of materials and sales of materials.

Q. Then, you say that you purchased materials for Gene Clark Plumbing Company as distinguished from Gene Clark, Inc. after May 1, 1946, is that correct?

(Testimony of Gene O. Clark.)

A. Would you state that question again, please?
(The question was read by the Reporter.)

The Witness: No, sir.

Q. (By Mr. Machtinger): Now, you stated the question before this, or perhaps two questions before, that Gene Clark Plumbing was in existence after May 1, 1946. A. That is correct.

Q. And you stated its function was for the purpose of purchasing materials and selling materials?

A. Correct.

Q. So that you did buy materials for Gene Clark Plumbing Company after May 1, 1946, is that correct, Mr. Clark? A. We bought materials.

Q. Who was "we"? A. Archie and I.

Q. Did you buy them for the corporation? [284]

A. We bought them for the inventory, whether it was the corporation or Gene Clark Plumbing.

Q. Did you consider that at any time when anyone purchased materials after May 1, 1946, that those materials did not belong to the corporation?

A. If they purchased materials, they would purchase them from Gene Clark Plumbing.

The Court: I don't get this at all. If who purchased materials it would be from Gene Clark Plumbing?

The Witness: Well, a customer.

The Court: Well, why would he purchase from Gene Clark Plumbing rather than Gene Clark, Inc.?

The Witness: Well, your Honor, at that time the reason why we did that was that the licenses had

(Testimony of Gene O. Clark.)

now been turned from Gene Clark Plumbing to Gene Clark, Inc. Now, the selling of materials, if you sold them for more than the ceiling, you were subject at all times to having your license taken away from you. Now, Gene Clark Plumbing was not the carrier of a license at this time, and should these sales be discovered, they couldn't take our license away from us.

The Court: So you did make over-ceiling sales for Gene Clark Plumbing, is that correct?

The Witness: Yes, sir.

The Court: Did you ever include them in your income tax return? [285]

The Witness: No.

The Court: Now, that was in 1946. What about 1947?

The Witness: We continued.

The Court: And didn't include them in your income tax return?

The Witness: No, sir.

The Court: As a matter of fact, you don't show any income in your income tax return from any plumbing business other than salary or what-not from Gene Clark Plumbing after 1946, do you?

The Witness: That is correct.

The Court: What about 1948? Did the same happen?

The Witness: Yes, sir.

The Court: What about 1949?

The Witness: Gene Clark Plumbing was no longer in existence.

(Testimony of Gene O. Clark.)

The Court: Well, isn't it a matter of fact that you dealt with Gene Clark Plumbing and Gene Clark, Inc. just about as you pleased without having any particular regard for the corporate entity at all?

The Witness: No, your Honor. The object of it all was to protect the corporation.

The Court: What do you mean by the protection of the corporation?

The Witness: Well, by Gene Clark Plumbing accepting [286] the responsibility of being caught in an over-ceiling sale, we protected the corporation, and also there was never a time that I believe either Archie Koyl or myself ever kept any of the monies between '46, '47 and '48, up until we sold.

The Court: You say you didn't keep the monies. You used them for materials, which again you resold at a profit, didn't you?

The Witness: Yes, sir.

The Court: Whether you kept the money or not, you did realize a profit from these over-ceiling transactions in '46, '47 and '48, didn't you?

The Witness: Your Honor, I believe the corporation received it.

The Court: You just got through saying ten minutes ago or less that Gene Clark Plumbing was the one that made the over-ceiling sales, so that if you got caught at it, you wouldn't lose your license?

The Witness: That's right, your Honor.

The Court: Well, Gene Clark Plumbing was not the corporation?

(Testimony of Gene O. Clark.)

The Witness: But, your Honor, if we put in, say, \$40,000 worth of materials in 1946, and we took out only \$40,000 worth in 1948, at the end of the time when it was needed, then, the sales or the profits, if any, would have reflected back to the corporation. [287]

The Court: Suppose it did reflect back to the corporation in the first instance. They were profit of Gene Clark Plumbing, weren't they?

The Witness: Yes, sir.

The Court: The inventory that was sold belonged to Gene Clark Plumbing. Gene Clark Plumbing sold it at a profit, sold it over-ceiling, isn't that correct?

The Witness: That is correct.

The Court: And never reported it?

The Witness: That is correct.

The Court: And ultimately, for better or for worse, the funds may have gotten into the corporation, but the corporation didn't report it either, did it?

The Witness: Yes, sir.

The Court: Well, when did the corporation report these over-ceiling profits that you are talking about for income tax purposes?

The Witness: I am not familiar with bookkeeping, but wouldn't it be when you get at the end of the year and you take the business and the inventory, wouldn't the balance be the profit?

The Court: Well, a great deal may be said about that, but there are no facts in this case to establish

(Testimony of Gene O. Clark.)

that you did anything of that sort and, if so, it would be a great deal of explanation required of it. The only thing we have gotten clear [288] so far is that you did make a profit as individuals, or joint adventurers, or whatever you may want to call it, separate and distinct from the corporation, which you didn't report in your income tax returns, isn't that correct?

The Witness: That's right.

The Court: And you didn't even have any normal books for Gene Clark Plumbing while you were doing this, did you?

The Witness: No, sir.

The Court: Well, what split-up was there, if any, between you and Archie Koyl as to these profits, or did you just get the benefit of it through your interest in the corporation?

The Witness: Your Honor, we didn't believe—I understand and I think you are correct—but we didn't believe there was a profit. We only got it in our corporation.

The Court: Mr. Clark, you didn't believe that there was a profit when you bought something at one price and sold it at a higher price? You didn't think that was a profit?

The Witness: Your Honor, I knew it was, yes, sir.

The Court: And you didn't report it. Now, incidentally, while I am asking you a few questions, I might well ask you a few more; aside from all of the preliminary statements and arguments that

(Testimony of Gene O. Clark.)

have been made, you understood what these transactions were for, that the agent described as substituted items, didn't you?

The Witness: Yes, sir, your Honor. [289]

The Court: And that was an intentional method of getting cash out of the corporation. You have testified it was for the purchase of materials, but in all events, it was an intentional method of getting money out of the corporation without actually recording it on the corporation's books, wasn't it?

The Witness: I am not awful sure I understand you.

The Court: Well, weren't you perfectly sure in your own mind that there were two items, and that one was substituted for the other, and that only one of the two was on your books?

The Witness: Your Honor, in all of this business, in the contracting business, when we took a contract to do a job for a given price, it was always my hopes and I always attempted to always have receipted and turned in for files all of the income from those jobs.

The Court: Well, Mr. Clark, you yourself testified that you used these methods to get available cash out of the corporation in order to buy materials. You testified to that, didn't you?

The Witness: Yes, your Honor.

The Court: Now, if you want to get cash out of the corporation, there has been other testimony—I don't know whether you have admitted it or not—But there has been other testimony that this method

(Testimony of Gene O. Clark.)

of not reporting certain sales on the books was your idea; is that correct or not? [290]

The Witness: That is correct.

The Court: It was your idea?

The Witness: Yes, sir.

The Court: You knew they weren't being reported, didn't you?

The Witness: The sales?

The Court: That's right.

The Witness: Yes, sir, your Honor.

The Court: You also assert that certain purchases weren't reported or additional amounts of cash paid out for purchases, but you do agree that sales were not reported on the books?

The Witness: Yes, sir.

The Court: Or any income tax returns?

The Witness: That's correct.

The Court: Where did you get that idea?

The Witness: Well, if somebody needed \$4,000 for merchandise, let's say, let's say it would be bathtubs, and we didn't have any bathtubs but we did have a lot of soil pipe, I would sell soil pipe to get the bathtubs.

The Court: That is a perfectly simple transaction. Why didn't you record these items on your books, the items that you admit were not recorded on your books or included in your gross income and your tax return? Why didn't you put them on your books? [291]

The Witness: Well, your Honor, I couldn't buy without cash.

(Testimony of Gene O. Clark.)

The Court: Well, you might not be able to buy without cash, but you could use cash and still put the record of it on your books, couldn't you?

The Witness: I am sure I could.

The Court: Well, why didn't you?

The Witness: I don't know.

The Court: Can't you do a little better than that, Mr. Clark?

The Witness: Well, as I said, I think that the hardest part was worrying about buying or selling over ceiling, and the priorities that we were using.

The Court: Well, you knew this affected your taxable income, didn't you?

The Witness: No, sir.

The Court: You didn't know that the omission of sales from your books and the omission of sales from your income tax returns, or the income tax returns of the corporation affected your income tax?

The Witness: Well, your Honor, I gave back the same amount of materials.

The Court: You gave back the same amount of materials, but you didn't account for the profits. You have already said that, haven't you? [292]

The Witness: Yes, sir.

The Court: Are you trying to tell me that if you bought a piece of property for \$50,000 and sold it for \$100,000 and then some time later took that \$100,000 and put it in another piece of property that you hadn't gained \$50,000?

The Witness: That is correct, your Honor, but that is what I felt the corporation would feel the

(Testimony of Gene O. Clark.)

profits of the retail sales. Of course, oftentimes, your Honor, there would be a profit, true, in the retail sale, but we also were paying terribly high prices, double to sell and double to buy back again.

The Court: All right. If you recorded all that on the books of your organization, then somebody might have been able to understand the net result. This way nobody can understand it, is that correct?

The Witness: That is correct.

The Court: Well, one other question and then I will permit Mr. Machtinger to proceed. Why was it that you reported on your income tax returns as you so testified at any rate, a 50-50 distribution between you and Archie Koyn in 1945, and I think in 1946, when you claim that was not the actual distribution?

The Witness: I signed them. I did not know.

The Court: You did not know it at the time?

The Witness: No, your Honor.

The Court: You know it now, don't you? [293]

The Witness: Yes, sir, your Honor.

The Court: Well, have you attempted to make any adjustment in that respect?

The Witness: I only knew it less than a month ago.

The Court: All right. Go ahead, Mr. Machtinger.

Q. (By Mr. Machtinger): Mr. Clark, did you and Mr. Koyn ever have an accounting at the end of either the calendar year on which you and Mr. Koyn figured your tax returns or at the end of the corpo-

(Testimony of Gene O. Clark.)

rate fiscal year as to what property belonged to the corporation and what property belonged to Gene Clark Plumbing?

A. Only when we took an inventory.

Q. You did take an inventory at the end of the calendar—at the end of the corporation fiscal year?

A. I am not sure we took it when Freddy told us to.

Q. And when Freddy Files told you to take an inventory, you took just one inventory, did you not?

A. That is correct.

Q. And that was the corporate inventory, was it not?

A. That was the combination of both.

Q. Did you and Mr. Koyl then get together and determine between yourselves what portions still belonged to you and what portions belonged to Mr. Koyl separately and apart from the corporation?

A. Didn't need to get together for that. [294]

Q. Did you ever tell him, or did he ever tell you, what each of you believed belonged to each other?

A. Yes, sir.

Q. What times did you confer to that extent?

A. That is available any time.

Q. Where was it available?

A. In my desk.

Q. What did you have in your desk that made it available?

A. I had two books that I kept that amount which we had spent and that amount which we had received.

(Testimony of Gene O. Clark.)

Q. What kind of books, were they, Mr. Clark?

A. I had two; I don't know. They are just notebooks that you would buy at the regular store, and then I also had one that I carried in my pocket.

Q. What did you record in these books?

A. In the office, I kept track of that which we had spent; that is, for example, Archie spent for materials or I did, and for the sales.

Q. When you refer to "we," you are referring there to you and Archie?

A. Yes, both of us did.

Q. As separate from the corporation?

A. That is correct.

Q. You allegedly recorded, then, what you and Mr. Koyl purchased outside of the corporation?

A. That is correct.

Q. For example, whom were you making these purchases for, Gene Clark Plumbing?

A. I don't know that I ever thought about it.

Q. You were just making purchases, is that it?

A. For the use of the corporation.

Q. And you would record the amounts of these purchases in this little black book, or whatever it was?

A. No, the one I had in my pocket was not necessarily the record. I only carried it because, oftentimes, if I were out on a job and sold materials or purchased some, in order not to forget, I simply made a note.

Q. And that little book you kept in your pocket contained records of purchases and sales by you?

(Testimony of Gene O. Clark.)

A. Yes, sir.

Q. What did the other books that you had in your desk contain?

A. The purchases and sales by myself and Koyl.

Q. What did you do with these records at any time?

A. I didn't do anything with them. I had them and Mr. Stutzman went over this.

Q. What was the purpose — aside from Mr. Stutzman—what was the purpose of keeping these records, Mr. Clark?

A. So that when, if there ever came a time when we could dispose of this inventory, he could have his share and I could [296] have mine.

Q. Did you ever use them for the purpose of computing profits or loss from your transactions?

A. No, sir.

Q. Did you ever show these books to anyone?

A. Yes, sir.

Q. Who saw these books?

A. Archie Koyl.

Q. Did you ever show them to your comptroller, Mr. Files?

A. I don't think so.

Q. Did you ever ask anyone to make any computations for you from these records?

A. No, sir.

Q. And these are the records which you state Mr. Stutzman took?

A. That is correct.

Q. When was Mr. Stutzman in to see you?

A. Mr. Stutzman was in about January of '49.

(Testimony of Gene O. Clark.)

Q. And for what purpose did he say he came to see you?

A. To check my personal records for the years of 1946, '47 and '48.

Q. And what record did Mr. Stutzman ask to examine? A. All of my records.

Q. Who was there when Mr. Stutzman came?

A. Archie Koyl, Chick Ring, Freddy Files, myself, or any [297] of the employees.

Q. And of whom did he ask for these records?

A. He asked Archie Koyl—no, he didn't ask him. He asked Archie to see me.

Q. And did you give him the records?

A. Not at that time.

Q. What records did you give him?

A. I just simply opened the file and let him look at any that he wanted to.

Q. What file did you open?

A. My personal file.

Q. Did he ask to see the Gene Clark Plumbing Company records?

A. That is what he was checking.

Q. And if this was for the year 1947 and 1948, I understand? A. '46, '47, '48.

Q. Well, did he examine the corporate records?

A. Not at all.

Q. Not at all. Did he check the corporate records at all for the purpose of determining whether you were properly reporting salaries from the corporation?

A. It is my opinion that Freddy Files asked

(Testimony of Gene O. Clark.)

him—it isn't an opinion—it is a fact; that Freddy Files asked him if he wanted to look at any of the books of the corporation and he [298] said, "I am not here to check the corporation." [299]

* * * * *

The Court: It seems to me this testimony was clear enough that he was in and out a few times and it extended over a period, but I don't see it makes any difference here. I don't understand that there is any contention on the part of the Petitioner that any of the formal books of the corporation or Gene Clark Plumbing are missing. The only thing that is claimed to be missing is this: What has been referred to as a private memorandum of Mr. Gene Clark.

Q. (By Mr. Machtinger): Just one further question in that connection. Did anyone see you give Mr. Stutzman these personal records, see you give Mr. Stutzman these personal records?

A. I don't know that I gave them to him in the shop. He worked with them in the shop.

Q. Are you now stating that you did not—whether anyone gave him the records including yourself?

A. I gave him the records.

Q. Did anyone see you give him the records?

A. I took them to his home.

Q. When you took them to his home, was that on your own volition?

A. He asked me.

Q. He asked you to come to his home with your records?

A. That is correct.

(Testimony of Gene O. Clark.)

Q. Can you give us the approximate date when he asked you to come to his home? [300]

A. It was shortly after he was at the shop.

Q. Did you come to his home in the daytime or the evening? A. In the daytime.

Q. And this was during a week day?

A. That is correct.

Q. And when you came to his home, you gave him the records and left, is that correct?

A. No, I stayed quite a little bit.

Q. And did you leave the records with Mr. Stutzman? A. That is correct.

Q. At whose request? A. At his request.

Q. Is it—Mr. Clark, is it not true that you were aware that the corporation's tax returns were not being properly filed, inasmuch as they did not report the true income of the corporation?

A. I believe they reported the true income.

Q. Is it true, Mr. Clark, that you instructed your comptroller, Mr. Files, to set aside all cash that was received from cash sales and turn that cash over to you? A. At different times.

Q. Isn't it a fact, Mr. Clark, that you pleaded nolo contendere to a charge of evading the payment of income taxes due by Gene Clark, Inc. for the years 1948 and 1949, by filing false income tax returns, knowing the same to be false and in [301] violation of Section 145b of Title 26 of the United States Code?

Mr. A. Baird: Just a moment. Were you through with your question?

(Testimony of Gene O. Clark.)

I would like to be heard on that, your Honor.

The Court: All right.

Mr. A. Baird: Now, if your Honor please, it is my understanding, and certainly it is the understanding of some of our United States District Court judges in this district that a plea of *nolo contendere* is a plea that is to be confined solely to the particular case, and that the reason that the plea has been preserved under the current criminal rulings of procedure, and the reason that it was preserved in the existing rule of criminal procedure were enacted, was to protect an individual from being embarrassed in some other proceeding; civil or otherwise, which had nothing to do with the particular offense which he was charged in the criminal court, and we think there is authority for that position, and I would like to direct your Honor's attention to a few notations that I have made.

I may say that this plea is discussed in the *Cyclopedia of Federal Procedure*, 3d Edition, Volume II, Section 43.41 and continuing in the section following, Section 43.42, we find this statement:

"The plea has been left in the rules of criminal procedure to preserve a sometimes useful device by which a defendant may admit his liability to punishment without being [302] embarrassed in other proceedings."

Now, the footnote to that is *United States versus Pannell*, a Third Circuit case in 1949.

The Court: Is that an anti-trust case?

(Testimony of Gene O. Clark.)

Mr. A. Baird: I cannot answer that from my note. I do not know.

The citation is 178 Federal 2d 98. An excerpt from that opinion states:

"It appears that the plea was left in the present Rule 11 of the Federal Rules of Criminal Procedure to preserve a sometimes useful device by which a defendant may admit his liability to punishment without being embarrassed in other proceedings."

That is found on page 100 of the volume to which I referred, 178 Fed. 2d.

The Court: Mr. Casey, will you make a note of that case so we can get the case for the Court, if necessary?

Mr. A. Baird: I will leave with you, Mr. Casey, this memorandum.

The Court: Go ahead.

Mr. A. Baird: In the well-known text, "Defending and Prosecuting Federal Criminal Cases," second edition, by Housel and Walser, the following observation is made:

"The admission of guilt by a plea of nolo contendere is confined to the case at bar; it is not competent evidence [303] against the defendant in other cause, civil or criminal."

And for reference to that, or footnotes to that editorial comment, is the United States versus Lair, 159 Fed. 47, and, in that case, certiorari was denied.

Now, I want to say to the Court that if we are going to get into this matter of a plea of nolo con-

(Testimony of Gene O. Clark.)

tendere, then, we would certainly want the right to bring in the circumstances under which it was entered; we would certainly want the Court to take cognizance of the fact that in this very case, this defendant was done a very grave injustice because this record shows beyond any question of a doubt that he was indicted for the filing of a false return of the corporation for a year in which he did not sign the return and at a time when he was not present and at a time when he had no interest in the corporation.

The Court: That is for one year?

Mr. A. Baird: As to one year, that's right, 1949.

The Court: That is not correct for 1948?

Mr. A. Baird: No, that was not correct as to 1948. But I do call that to the Court's attention, that those are the facts with reference to it.

Now, I do want to say further, that from my experience and the actual practice before our United States District Judges here, two other judges, in cases which I have personally appeared, in answer to objection which the United States District [304] Attorney as required by the Department of Justice to make to the receiving of a plea of nolo contendere, have taken the view that if there is some subsequent civil proceeding growing out of the same or similar transactions that it is proper basis for a plea of nolo contendere, and for that reason, two different cases in which I have appeared before two different judges, in this district, that plea has been accepted.

(Testimony of Gene O. Clark.)

And I think that for the reasons that I have stated, that it is wholly irrelevant and incompetent for this matter of what was done in criminal proceeding in the way of a plea of nolo contendere to be received.

Mr. Machtinger: If the Court please, the question of whether a plea of nolo contendere can be admitted in the record in a cause similar to this one as expressed before the Tax Court in the recent case of Lillian Kilpatrick versus Commissioner, cited by the Tax Court on May 28, 1945, and which is reported 22 Tax Court No. 59. In that case, the Tax Court stated that petitioners had made motions at the hearing to strike an exhibit, which exhibit was a certified copy of the judgment of the Court pursuant to the petitioner's plea of nolo contendere, and all references in the transcript relating to the nolo contendere pleas of petitioner, and one of her witnesses and their subsequent convictions thereon for income tax evasion for the years 1943, '44, and '45.

The Court stated that there were two questions raised. [305] First, whether the evidence as to their conviction is admissible in respondent's cross examination proper for purposes of impeaching the testimony of the petitioner, and whether the record of petitioner's conviction is admissible to prove her alleged fraudulent intent for the years 1943, '44, and '45.

In holding that the evidence was admissible, the Court stated that the Tax Court is bound by the

(Testimony of Gene O. Clark.)

rules of evidence applicable in the Court of the District of Columbia and the type of proceedings, which prior to September 16, 1938, were within the jurisdiction of the courts of equity of that District.

The Court stated that the term "conviction" used in the District of Columbia includes convictions based on *nolo contendere* pleas as well as based on jury verdicts. The Court denied petitioner's motion, that is, admitted the court record of conviction. In that connection they stated, we think they are admissible for impeachment purposes, as would be any conviction of crime committed by any witness and that they may be noted as part of the background of the present case.

The Court held, however, that it would refrain from deciding whether it was permissible to consider petitioner's plea as fraud issue.

Now, in this particular case, if your Honor please, the witness has denied that he had any knowledge that the corporation was filing false income tax returns. It would appear [306] to be relevant to the issue that the witness did plead *nolo contendere* to a charge which involved the corporation for years before this Court in view of the Tax Court's holding on this point, it is my contention that the question is proper and that there should be admitted a certified copy of the judgment of the District Court in the criminal proceeding.

The Court: Is that an opinion by Judge Oppen?

Mr. Alva C. Baird: Yes, it is, your Honor.

The Court: May I see it?

(Testimony of Gene O. Clark.)

Mr. Alva C. Baird: May I call your Honor's attention to the fact that he specifically does not make any ruling to the effect of this competence to evidence to show fraud in this case?

The Court: Mr. Reporter, will you read the question which Mr. Machtinger asked the witness, to which petitioners' counsel objected.

(The question was read by the reporter.)

The Court: All you asked is if he had filed a plea of nolo contendere. As to that particular question, I will sustain the objection. Whether you want to rephrase it or not, it is up to you.

Mr. Machtinger: I do.

Q. (By Mr. Machtinger): Mr. Clark, you stated that you were not aware that the corporation was filing false and fraudulent income tax [307] returns, or the corporation was not reporting its true income on its returns, let's say, for the years 1948 and 1949, is that correct?

A. I was not aware.

Q. Why did you file—

Mr. Alva C. Baird: Would you pardon my interruption for just one question. May it be stipulated that he had nothing to do with the 1949 return?

Mr. Machtinger: No, I won't enter such a stipulation.

Mr. Alva C. Baird: Very well, go ahead.

Q. (By Mr. Machtinger): Why did you file a plea of nolo contendere to an indictment charging you for the offense of evading the payment of in-

(Testimony of Gene O. Clark.)

come tax due by Gene Clark, Inc. for the years 1948 and 1949, by filing false income tax returns?

Mr. Alva C. Baird: Just a moment, if your Honor please, I will want to ask that precise question, and will do so if permitted by the Court, if the Court rules against my position and holds that it is proper and admissible for Mr. Machtinger to establish that.

The Court: The question assumes that a plea of nolo contendere was filed, which is precisely the issue here. So far this question, just as the other one, has been limited to a plea of nolo contendere. If there is an objection—— [308]

Mr. Alva C. Baird: There is an objection.

The Court: Then, again as to the particular question, the objection is sustained.

Q. (By Mr. Machtinger): Mr. Clark, is it true you were convicted upon a plea of nolo contendere of an offense of evading payment of income tax by Gene Clark, Inc. for the years 1948 and 1949, by filing false income tax returns?

Mr. Alva C. Baird: Now, we renew our objection to that, and to the introduction of any records pertaining to any plea that he made of that kind.

The Court: Objection overruled. Answer the question.

The Witness: I was.

Q. (By Mr. Machtinger): Mr. Clark, would you look at this——

Mr. Machtinger: Would you please mark this Respondent's exhibit next in order?

(Testimony of Gene O. Clark.)

The Clerk: Respondent's Exhibit CCC marked for identification.

(Respondent's Exhibit CCC was marked for identification.)

Mr. Machtinger: If the Court please, I offer as Respondent's Exhibit CCC, a certified copy of the judgment of the District Court convicting Mr. Clark on his plea of nolo contendere of the offense of evading the payment of income tax by [309] Gene Clark, Inc. for the years 1948 and 1949 by filing false income tax returns.

Mr. Alva C. Baird: For the record, we renew our objection.

The Court: You are not objecting on the ground of lack of certification, as I understand it, but on the same grounds as previously?

Mr. Alva C. Baird: That's right.

The Court: It purports to be certified and I assume that it is. I will overrule the objection.

The Clerk: Respondent's Exhibit CCC will be admitted in evidence.

(Respondent's Exhibit CCC was received in evidence.)

Q. (By Mr. Machtinger): Mr. Clark, did you keep any of the cash that you received from the corporation for your own use other than sale—

The Court: I may say before you go into it further that—well, as I understand it, your objection was general as to the admissibility of the fact of conviction, is that correct?

Mr. Alva C. Baird: That is correct. And spe-

(Testimony of Gene O. Clark.)

cifically, I am objecting to it as any evidence of fraud in this case.

The Court: Well, I will admit for the purpose of impeaching the witness, and I will reserve consideration for argument on the briefs as to whether it may or may not be deemed [310] evidence of intent or any of the other elements of fraud for the purpose of this particular case.

Mr. Machtinger: Will you strike the last question, I will rephrase that question.

Q. (By Mr. Machtinger): There has been testimony, Mr. Clark, to the effect that Mr. Files, the comptroller, turned over cash received from sale of corporate stock to you, and that the sales were not recorded in the corporate records. Did you keep the proceeds of such cash for your own use?

A. No, sir.

Q. Now, Mr. Clark, in your 1948 and 1949 income tax returns, joint returns of you and your wife, you claimed approximately \$17,000 in farming expense for each of those years, which was conceded by the Government. Where did you get the \$34,000 that you used for the farm expenses?

A. That was my personal bank account.

Q. Where did you get the money that was in your personal bank account that you used for those expenditures?

A. By the sale of my materials.

Q. Didn't you testify shortly before that you used all the proceeds from the sale of your materials for the purpose of other materials?

(Testimony of Gene O. Clark.)

A. No, sir.

The Court: You mean you didn't say that or didn't do [311] it?

The Witness: I didn't do it.

The Court: Well, you did testify, didn't you, that you used all the money for the purchase of other materials?

The Witness: Not when I sold my inventory.

The Court: All right, go ahead.

Q. (By Mr. Machtinger): Do you recall how much in addition to the \$34,000 you had that you realized from the sale of the materials?

A. No, I don't.

Q. During what periods of time did you accumulate this money; during 1946?

A. No, sir.

Q. What period of time did you get the money?

A. That was accumulated over many years.

Q. Specifically when, Mr. Clark?

A. I accumulated that back as far as, oh, my goodness, back as far as '34.

Q. Mr. Clark, when you borrowed the \$10,000 from the Valley City Supply Company, which you used as part payment for the purchase of the North Farm, did you give a note to the Valley City Supply Company? A. Not to my knowledge.

Q. Did you give a note to the corporation when you borrowed the balance of the moneys necessary for the purchase of [312] the farm?

A. Not to my knowledge.

Q. Do you have a copy of the agreement which

(Testimony of Gene O. Clark.)

was admitted as Petitioners' Exhibit 27, and which contains this Paragraph 8, which in Petitioners' Exhibit 27 has the word "void" struck through it; do you have in your own personal records a copy of this agreement? A. I do not.

Q. Why, Mr. Clark, was it decided to buy a farm in Archie's name?

A. He indicated that he would like to own a farm.

Q. In other words, was the farm purchased for him because he thought if corporate profits were used for the purchase of a farm for you, such profits should be used for the purchase of a farm for him? A. No, sir.

Q. Were you just being nice to him and gave him a farm? A. I did not give him a farm.

Q. Is it true that you took approximately eight or ten thousand dollars up to Kansas and applied such money toward the purchase price of Mr. Koyl's farm? A. I did.

Q. Where did you get the money?

A. From the sale of Gene Clark Plumbing materials.

Q. And was this considered his interest in those [313] materials? A. It was.

Mr. Machtinger: No more questions, your Honor.

* * * * *

Redirect Examination

Q. (By Mr. Alva C. Baird): Mr. Clark, I show you Petitioners' Exhibits for identification 30 and

(Testimony of Gene O. Clark.)

31, I will ask you if you can identify the signatures on those documents?

A. They are mine and my wife's.

Q. And what are these documents?

A. They are a note to the Independent State Bank at Independence, Kansas.

Q. And is that true of both of the documents?

A. It is.

Q. And those are notes for money that you borrowed from the Independent State Bank?

A. It is.

Q. What are the dates of these notes?

A. February the 5th, 1948. [314]

Q. What is the amount of each note?

A. \$14,000 each.

Q. Are we to understand that on that date you borrowed \$28,000 from the Independence Bank at Kansas? A. That is correct.

Q. Have these notes been paid off?

A. They have.

Q. And when were the final payments made, if you know? A. I am not sure.

Q. Well, were they made after 1948 or 1949?

A. They were made, I believe, in 1950.

Q. That is, we are referring now to the final payment. A. Final payment.

* * * * *

Q. (By Mr. Alva C. Baird): Those were notes and mortgages on what? [315]

A. On two farms.

(Testimony of Gene O. Clark.)

Q. Where were the farms?

A. We referred to them as the north and south farms.

Q. And those are the farms on which you incurred the operative losses?

A. That is correct.

Q. Now, Mr. Clark, Mr. Machtinger has opened the matter of your entering a plea of nolo contendere in the United States District Court to two counts. Will you relate to the Court the circumstances under which the plea was entered?

Mr. Machtinger: I object to that question.

Mr. Alva C. Baird: Why?

Mr. Machtinger: I will state the reasons. The plea of guilty to the charge of any crime which is a felony can be used for the purpose of impeaching the credibility of a witness. It is my understanding that they do not go to the background of that guilty judgment and they do not go into the facts which lead up to that guilty judgment, and that it is the judgment itself and the fact that the witness or the defendant who was adjudged guilty, it is the fact that he was judged guilty that is used for the purpose of impeaching the credibility of the witness. If counsel will concede that the conviction on the plea of nolo contendere can be used for the purpose of going to the fraud of the petitioners in this case, then, I can see where it may be pertinent to go into the background of that judgment [316] and that plea.

(Testimony of Gene O. Clark.)

The Court: You have urged it for that purpose, haven't you?

Mr. Machtinger: Yes, I have, Your Honor. I have urged it for that purpose.

The Court: I don't think counsel has to concede that your purpose is correct.

Mr. Machtinger: Well, then, I would object to that question and any matters relating to that question unless the Court ultimately decides to our arguments in brief, that the conviction on the nolo plea goes to the issue of fraud in this case.

The Court: Well, I will reserve ruling on this testimony in relation to the particular issue of fraud and intent as distinguished from impeachment until final determination, and in the meantime, permit counsel to question the witness.

Mr. Machtinger: I would have no objection—am I to understand, if the Court decides that the conviction on the plea of nolo contendere cannot be used for the purpose of determining whether or not there was fraud in this case, that these questions will not relate at all to the impeachment aspect of it?

The Court: I see no need of determining that at the moment, Mr. Machtinger, if you want to object to them, especially on that ground, I have no objection to your protecting the [317] record on it. I am going to let this witness explain, subject to motion to strike and to argument on the brief.

Mr. Machtinger: I would like the record to show, then, that respondent objects to any testi-

(Testimony of Gene O. Clark.)

mony relating to the question in issue by counsel, if the judgment and plea of *nolo contendere* is used solely for the purpose of impeaching the credibility of the witness.

The Court: Very well, proceed.

Q. (By Mr. Alva C. Baird): Mr. Clark, before I proceed with the question, will counsel stipulate for the record that the criminal charges against Gene Clark individually or for his individual income tax returns were dismissed by the United States Attorney?

Mr. Machtinger: No, sir, we have made no reference to any criminal charge against Gene Clark for his own income tax.

Mr. Alva C. Baird: Do you deny that fact?

Mr. Machtinger: I am not on the witness stand, I don't think I have to deny anything.

Mr. Alva C. Baird: You may compel me to go to the trouble of getting certified copies of the records, then, if you want to do that, all right.

Q. (By Mr. Alva C. Baird): Mr. Clark, there has been offered in evidence here a certification to the effect that you entered a plea of *nolo* [318] *contendere* on charges of filing or causing to be filed a fraudulent income tax return for Gene Clark, Inc. for the years 1948 and 1949. Now, directing your attention first to the year 1949, I will ask you if you had anything to do with Gene Clark, Inc. at the time fiscal year 1949 came to an end, April 30, 1949, and at the time the return was filed in July, 1949?

A. I did not.

(Testimony of Gene O. Clark.)

Q. Isn't it a fact that prior to that time that you had sold all of your interest in the Gene Clark, Inc. to Archie Koyl? A. That's right.

Q. The record shows from the return itself that the return was filed by Archie Koyl and Fred Nodds. Now, I will ask you if you gave them any instructions or directions or any help in the preparation of that 1949 return? A. I did not.

Q. Did you ever see the corporation return prior to the time it was introduced here in evidence in this case? A. I have not.

Q. Now, coming down to the year 1948 and '49, I will ask you where you were located, where you were residing at the time the indictment was returned against you and brought before the United States District Court here in Los Angeles?

A. I was at Independence, Kansas. [319]

* * * * *

Q. When you made your first appearance before Judge Peirson M. Hall in regard to this matter, were you accompanied by counsel?

A. No, sir.

Q. And what instructions did you receive from Judge Hall?

A. He stated that I should go back on my own cognizance and obtain an attorney.

Q. And did you later appear a second time with an attorney?

A. No, sir. I appeared a second time without an attorney.

(Testimony of Gene O. Clark.)

Q. And why had you not observed the Judge's instructions to obtain counsel?

A. I had no money and I couldn't hire one.

Q. And was the reason of your being out of funds the fact [320] that the United States Government in this proceeding pursuant to a jeopardy assessment, had sold out all of your assets and property in Kansas?

* * * * *

The Witness: That is correct.

Q. (By Mr. Alva C. Baird): In other words, these farms about which we have been testifying had been sold to satisfy the jeopardy assessment?

A. Not those particular farms, but the one that I had left was.

Q. Now, did you subsequently obtain an attorney? A. Yes, I did.

Q. And that was Mr. Landon Morris?

A. That's correct. [321]

* * * * *

Q. What caused you to reach the conclusion that you should enter a plea of nolo contendere?

A. Mr. Landon Morris advised me to do so.

* * * * *

Recross Examination

Q. (By Mr. Machtinger): Mr. Clark, were you not warned by the District Court Judge who sentenced you, that a plea of nolo contendere could, that even though you plead to nolo contendere, you could be [326] found guilty and sentenced as if you were guilty?

(Testimony of Gene O. Clark.)

Mr. Alva C. Baird: I will stipulate without knowing what was done, that he advised Mr. Clark that the same penalty could be imposed as if he had entered a plea of guilty.

Mr. Machtinger: So stipulated.

Q. (By Mr. Machtinger): Mr. Clark, the corporate books were kept on fiscal years ending on April 30, isn't that correct?

A. That is correct.

Q. Were you not an officer of the corporation and sole owner of the corporation for the period May 1, 1948 until on or about February 4th, 1949?

A. That is approximately right.

Q. And were not the books and records for that period kept under your direction? [327]

* * * * *

Q. The last question, Mr. Clark, was whether it was true that until the time you left the corporation approximately February, 1949, the books and records were kept under your direction?

A. They were kept under Freddie Files' direction. [330]

Q. I recognize that Mr. Files was the one who was in charge as comptroller, but was it not true, that he received his orders from you as to what should or should not be placed in the records as to what sales should or should not be recorded, what purchases should or should not be recorded?

A. I have never given Freddie an order as to the corporation's books.

(Testimony of Gene O. Clark.)

The Court: Now, as to this fiscal year ending April 30, 1949, that you are talking about——

Mr. Machtinger: Yes, sir, I am referring to the period between May 1, 1948 and approximately February 1, 1949.

The Court: Well, your methods with respect to unrecorded sales of merchandise weren't any different in that year than they were in the previous years, were they?

The Witness: No, Your Honor.

* * * * *

Redirect Examination

Q. (By Mr. Alva C. Baird): Mr. Clark, you had nothing to do with the corporation or Freddie Files, or anything to do with the corporation after February, 1949, did you? A. I did not.

Q. Now, Mr. Clark, will you state whether or not you have any opinion or can give any estimate as to whether the amount [331] of cash which you took from the corporation for the purchase of over-ceiling goods was offset by—and which was not recorded on the books or in the returns, was offset by the excess cost which you had to pay for materials which went to the corporation?

Mr. Machtinger: I object to that question. The question calls solely for a conclusion of the witness not based on any records, not based on any evidence.

The Court: That goes to the weight of it. He can make a statement why he wanted to do it, if he wasn't making a profit, is also perhaps something

(Testimony of Gene O. Clark.)

he might explain. But I will overrule the objection.

The Witness: I always felt that the cost was offsetting the profits and the reason why, Your Honor, I did it, was to dispose of materials that I had in quantity to get those on which I was short. * * ° * *

KENNETH S. STUTZMAN

was called as a witness by and on behalf of the respondent, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name.

The Witness: Kenneth S. Stutzman.

The Clerk: Your address?

The Witness: 4836 North Earl Street, Rosemead.

Direct Examination

Q. (By Mr. Machtinger): What is your occupation, Mr. Stutzman?

A. I am now a collection officer for the Internal Revenue Department.

Q. How long have you been with the Internal Revenue Service?

A. Since December, 1945.

Q. And during the time that you have been with the Internal Revenue Service, have you ever been sent out to audit [333] taxpayers' books and records?

A. I did that almost exclusively from that time until last year, when my title was changed.

Q. And during the time when you were so audit-

(Testimony of Kenneth S. Stutzman.)

ing books and records did you have occasion to call on Mr. Clark of Gene Clark, Inc.? A. I did.

Q. Was that for the purpose of auditing the tax returns of Gene Clark?

A. It was for the purpose of investigating a complaint letter which had been received in our office, anyway, of an informant's letter.

Q. And did you go to the offices of the Gene Clark, Inc.? A. I did.

Q. Approximately what month and year?

A. I don't remember what month, but it was in 1949, I believe.

Q. And during the time that you were there, did you examine any books and records of the corporation? A. Yes.

Q. Did you examine any other books and records? A. No, I saw no others.

Q. Did you examine any books and records of an organization that was entitled Gene Clark Plumbing Company?

A. No, that was Gene Clark, Inc. [334]

Q. Did you take any books and records with you when you left the office of the Gene Clark Corporation?

A. No, my examination was made at the office.

Q. At whose office?

A. At the Gene Clark office in El Monte.

Q. Did you at any time that you were at that office examining books and records take with you any books and records of any organization?

A. I did not.

(Testimony of Kenneth S. Stutzman.)

Q. Did anyone ever bring to your home any books and records relating to your investigation of Gene Clark? A. No, sir.

Q. During the time that you——

The Court: Now, let's get it clear. Up to the moment you have been talking about Gene Clark, Inc. Now, did anyone, did you take any records or did anyone deliver any records to your home relating to the individual returns of Gene Clark or his wife or joint returns of Gene Clark and his wife?

The Witness: No records were brought to my home either by myself or any other person or Gene Clark in person, Gene Clark, Inc., or Gene Clark Plumbing.

The Court: All right.

Q. (By Mr. Machtinger): Did Mr. Clark show you while you were at the office of Gene Clark, Inc. any personal records relating to him or his [335] activities?

A. I saw only the payroll records for Gene Clark, Inc.

Q. Did you confer directly with Mr. Clark himself? A. Yes, at times.

Q. Was he the person who turned over to you the corporate records?

A. I don't remember, I talked with him and also talked with Mr. Koyl. I don't remember which one gave me the corporation books.

Q. Have you ever brought to your home, or do you make a practice of bringing to your home any

(Testimony of Kenneth S. Stutzman.)

records relating to an individual or relating to any entity which you are investigating? A. No.

The Court: Never mind your practice. Did you bring anything to your home in connection with Gene Clark, Inc., Gene Clark individually, or Gene Clark's wife, or Gene Clark and his wife?

The Witness: The only records that might have been at my home would have been those in my brief case, which would be in the nature of a report to be made the following day upon coming to work.

The Court: Those were your records?

The Witness: That's right.

The Court: Did you take any of the taxpayers' records, corporate or individually? [336]

The Witness: No.

Q. (By Mr. Machtinger): Did Gene Clark or any of his representatives bring any of the tax records, corporate or individual, to your home for examination or for any other purpose?

A. No.

Mr. Machtinger: No further questions.

Cross Examination

Q. (By Mr. Alva C. Baird): Mr. Stutzman, you mean to say Mr. Clark was never at your home at any time? A. I didn't say that.

Q. Well, I am asking you, was he?

A. He was in my home, yes, sir.

Q. And was he there on more than one occasion? A. Yes.

(Testimony of Kenneth S. Stutzman.)

Q. Did you discuss this case with him when he was there?

A. The last time, I did. The first time the subject wasn't connected with income tax.

Q. A subject that wasn't connected with income tax? A. That's right.

Q. What was the occasion of Mr. Clark being at your home?

A. At the time I was interested in raising orchids, and he came up to see the plants that I had. [337]

Q. Well, how long had you been acquainted with Mr. Clark? You are not from Kansas, by any chance, are you?

A. No. Does that make any difference?

The Court: Answer the question.

The Witness: What is the question again, your Honor?

The Court: Read the question.

(The pending question was read by the reporter.)

The Witness: The only way I can answer that question is by making a qualified answer, and that is, I became acquainted with Mr. Clark on my first call at his office at Garvey Boulevard after the examination was completed. It might have been a week, it might have been two weeks, the first time he came to my office. I had known him about two weeks.

The Court: Office or home?

The Witness: Home, that's right.

(Testimony of Kenneth S. Stutzman.)

Q. (By Mr. Alva C. Baird): And then, when did he come to your home again?

A. After he had gone to Kansas. I don't remember that date, it seems about like a year and a half or two years ago he came with an attorney, found me working in my front yard.

Q. Do you know who the attorney was?

A. I don't remember his name, no, sir.

Q. Was the name McVey?

A. That seems familiar, but I don't remember if that was the man or not. [338]

Q. Was he introduced to you as being an attorney from Kansas, Mr. Clark's attorney from Kansas?

A. Yes, sir.

Q. What did Mr. McVey and Mr. Clark come to your home for on that occasion?

A. They wanted some advice on how to proceed in this tax assessment which had been made by other persons.

Q. Well, did they ask you about any records that they were looking for, personal notebooks or anything of that kind that they had been unable to find?

A. They asked about records that I might have had in our own office, which is routine.

Q. Well, did they ask you about any of their own records, and by records, I mean memoranda, books or schedules?

A. No.

Q. Or any papers that were personal papers of Mr. Clark?

A. No.

Q. Did you see any records of Mr. Clark other

(Testimony of Kenneth S. Stutzman.)

than the payroll records of Gene Clark, Inc.?

A. No.

Q. That is the only documents that you saw in connection with this examination?

A. That is the only one I examined. I saw other records in the office.

Q. I mean, that is the only one you looked at?

A. Yes.

Q. Now, as I understand, you went there on an informant's claim? A. That's right.

Q. Who was that informant?

A. I don't know——

Mr. Machtinger: I object.

The Court: Objection sustained.

Q. (By Mr. Alva C. Baird): How long did you work on this case?

A. About three hours one day, and I called back about an hour on another date. It was very brief the last time.

Q. You called back, you mean you went back or you telephoned?

A. I went back in person.

Q. In person. Did you have intermittent conferences on the telephone with Mr. Clark about matters? A. None that I recall. [340]

* * * * *

GENE O. CLARK

was recalled as a witness by and on behalf of the petitioners, and, having been previously duly sworn, was examined and testified further as follows: [347]

Direct Examination

Q. (By Mr. Alva C. Baird): Mr. Clark, I will ask you whether or not some time in 1946 you and your wife, Faye Clark, acquired certain farm property in Montgomery County, Kansas?

A. We did.

Q. And what was the nature of that farm; what type of farm was it?

A. That is a grain farm.

Mr. Machtinger: What was that?

Mr. Alva C. Baird: A grain farm.

Q. (By Mr. Alva C. Baird): Wheat and oats?

A. Yes, sir.

Q. Did you produce anything else on that farm?

A. No, sir.

Q. At the time you acquired it—what month did you acquire it in, do you remember?

A. I do not. I believe in September.

Q. To refresh your recollection, was it acquired some time in July, 1946?

A. It was in the summer, it would have been in the warm weather.

Q. Now, at the time you acquired that farm, was there any growing crop on it?

A. No, sir, it wasn't used at that time. [348]

Q. It wasn't in use at that time?

A. That is correct.

(Testimony of Gene O. Clark.)

Q. Now, what did you do in the fall with reference to putting it into use?

A. We planted it to wheat.

Q. You planted the entire farm to wheat?

A. 300 acres.

Q. 300 acres. And how long does it normally take a crop of wheat in that area to mature?

A. We usually combine in July.

Q. In July of the following year? A. Yes.

Q. So that if you planted in October, you would expect to harvest your crop in July of the next year? A. That's correct.

Q. You did not harvest any crop in 1946, then?

A. No, sir.

Q. Now, did you harvest any crop in 1947?

A. No, sir.

Q. Well, you planted a crop in '46, did you not, 300 acres? A. That is correct.

Q. Well, will you explain to the Court why you failed to harvest anything in 1947?

A. That is a bottom farm, that we call down on the river [349] bottom, and it overflowed.

Q. The river overflowed? A. Yes, sir.

Q. Did it destroy the entire crop that you had planted in 1946? A. It destroyed it all.

Q. Did you harvest any of it?

A. Not at all.

Q. Well, then, during the year 1946—or the year 1947, if I understand your testimony, you harvested nothing? A. That is correct.

(Testimony of Gene O. Clark.)

Q. Now, you had some expenditures in connection with that operation, did you not?

A. We did.

Q. Now, do you know with reference to the year 1946 what your expenditures other than such items as might have been capital, as to what they were?

A. They were approximately \$2,000.

Q. Approximately \$2,000. And do you have some checks showing these expenditures?

A. I do.

Q. I will ask you to look at these various checks, and I notice one, October 17, '46, for seed wheat \$100.15, and that is drawn on the special account No. 1.

A. That is correct, signed Clyde R. Clark. [350]

Q. Now, have you examined this group of checks that I have here, and are these the checks that make up the expenditures to which you have referred?

A. They are.

Mr. Alva C. Baird: Would you like to see these, Mr. Machtinger?

Mr. Machtinger: Are you offering them in evidence, Mr. Baird?

Mr. Alva C. Baird: I will offer them in evidence. There is one group of checks.

We would like to offer as Petitioners' Exhibit next in order a group of checks, 23 in number, and running from checks numbering 4602 to 4628, inclusive.

Mr. Machtinger: If the Court please, I object to the admissibility of any of these checks on the

(Testimony of Gene O. Clark.)

ground that a proper foundation for these checks has not been laid, except for the very last check every one of these checks are drawn by someone other than the witness; there is no record to substantiate that any of these checks drawn are for any farm expense of any nature. These are merely a group of checks drawn and signed by one Clyde R. Clark who is not here. We have no basis for knowing what these checks specifically are for other than this witness has said these checks, which allegedly are for some farm expenses. Unless we have Mr. Clyde R. Clark here who can testify, he is the one who drew these checks, if your [351] Honor please, or unless other books which are here substantiate the witness' testimony, I think that these checks are improper for the purpose offered.

The Court: What was the last check you speak of?

Mr. Machtinger: The last check is signed by Gene Clark, just what it is for, I don't know. It is made out, signed by Gene Clark to Clyde R. Clark. It is labeled, "To close account." Or not labeled, there is a notation, "To close account." It is for \$108.89, but what that check is for, I also do not know.

The Court: I certainly don't think any foundation has been laid for these checks, with the possible exception of one, which the witness identified, and now counsel states to me that wasn't signed by him. If you want to establish those checks, Mr. Baird, you will have to take them up one by one

(Testimony of Gene O. Clark.)

and let's see what the circumstances were, if this witness knows.

Mr. Alva C. Baird: All right.

The Court: Please don't lead him on this.

Mr. Alva C. Baird: Very well.

Q. (By Mr. Alva C. Baird): I show you Check No. 4602, and ask you to identify, if you can, what that check is for?

A. That is for Dad's salary.

Q. And your Dad is Clyde Clark?

A. Clyde R. Clark. [352]

Q. Clyde R. Clark. And what was his salary for?

A. That is for working on the farm.

Q. And this is a check for \$450?

A. Yes, sir.

Q. And that is in payment of wages incurred on that farm? A. That is correct.

The Court: For what period?

The Witness: It doesn't state the period.

The Court: Well, you know what period.

The Witness: No, your Honor.

The Court: Did you have any other farm at that time?

The Witness: No, your Honor.

The Court: Only the one?

The Witness: Yes, sir.

The Court: What salary, or what salary basis, do you claim that you paid your father?

The Witness: \$50 a week.

Mr. Machtinger: \$50 a week?

(Testimony of Gene O. Clark.)

The Witness: Yes, sir.

The Court: All right, go ahead, Mr. Baird.

Q. (By Mr. Alva C. Baird): I show you 4603——

The Court: Better offer these checks one by one.

Mr. Alva C. Baird: I will offer No. 4602, Petitioners' [353] exhibit next in order.

Mr. Machtinger: I object to the admission of the check as evidence. It is not drawn by the witness, it is signed by Clyde R. Clark, made out in favor of Clyde Clark.

The Court: All right, I will sustain you up to the moment, I will give him a chance to explain further, if he can.

Q. (By Mr. Alva C. Baird): Mr. Clark, was your father, Clyde R.——

The Court: Don't lead him, please.

Mr. Alva C. Baird: Very well.

Q. (By Mr. Alva C. Baird): Will you state who was authorized to draw checks on Special Account No. 1 of Gene Clark, Inc.?

The Court: Of Gene Clark, Inc., was this?

The Witness: Gene Clark, Inc., Special Account No. 1. Clyde R. Clark was, and I was.

Q. (By Mr. Alva C. Baird): Was anyone else?

A. I don't know of anybody else.

Q. During this period of time, do you know whether anyone else was?

A. I don't believe they were.

The Court: Then, this is a check of Gene Clark,

(Testimony of Gene O. Clark.)

Inc., and not of this witness at all, is that correct?

Mr. Alva C. Baird: It is a check on an account [354] labeled Gene Clark, Inc., Special Account No. 1.

The Court: All right, it wasn't Gene Clark, Inc. account, was it?

The Witness: It was Gene Clark, Inc., and I borrowed it, it was Gene Clark, Inc. account No. 1, and I had borrowed the \$5,000 to deposit.

Mr. Alva C. Baird: I will say to your Honor that we will connect up that \$5,000. It is already referred to in Petitioner's Exhibit 19 on the ledger sheet, and it is also, I believe, reflected in the bank account, which we will have here.

Q. (By Mr. Alva C. Baird): Now, coming back now to Check No. 4602, directing your attention to the notation down in the bottom, "Salary," do you know whose writing that was?

A. That is Dad's, Clyde R. Clark's.

Q. Clyde R. Clark's. Will you state what this check was for?

A. That is for nine weeks' salary.

Q. For nine weeks' salary?

A. That's correct.

Q. Was your father engaged by you?

A. That's correct.

Q. Wait a minute. To do any other service or work other than on the farm? [355]

A. Just the farm.

Q. Just the farm.

(Testimony of Gene O. Clark.)

Mr. Alva C. Baird: We offer the check, your Honor.

Mr. Machtinger: May I see the check? Is this the same check that was just offered before?

The Witness: Yes.

Mr. Machtinger: If the Court please, I again object to the admissibility of this check. There is nothing except the self-serving word "salary" to indicate this check is for salary, there is no proof here that the check was drawn for that purpose, other than the word "salary" that was written by the same person who drew the check in his own favor. The witness has not established by any other source that is here in the courtroom that there were any expenditures necessitated at that time for salaries.

The Court: Well, Mr. Machtinger, I am going to let it in just to move along. As far as I am concerned, up to the moment, unless it is connected up a great deal further than it is now, I am not impressed with its probative force. Mr. Baird has said he is going to follow it up, and it will be subject to motion to strike consideration later.

Now, I might add that if there are any more bunches of checks brought in here on this farm situation to indicate expenditures, I would like to have some advance announcement as to whether they are for Dad or some other member of the family [356] before they are offered in a lump.

Mr. Machtinger: In the interest of time, if your Honor please, I reserve the right to object to each

(Testimony of Gene O. Clark.)

of these checks until they are all testified to, or would you prefer——

The Court: You do it in your own way. If you want to have each one of them identified, which, as I understand it, you did, all right; if you don't, say so, I can't tell by looking at them, and certainly there is enough indication already that by the fact of who drew them, who they were drawn on, whose account it was, and so forth, to indicate that they might be subject to some inquiry.

Mr. Machtinger: I think it is essential that each one of these checks be identified individually. My only thought was that in the——

The Court: I am not going to take a bulk objection to these checks. You will have to object to each one.

Mr. Machtinger: Yes, sir.

The Clerk: Petitioners' Exhibit 32 admitted in evidence.

(Petitioners' Exhibit No. 32 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you a check No. 4605, for \$102.15, and ask you if you know what that check is for? [357]

A. That check is for seed wheat.

Q. And how do you determine that?

A. It so states in the description.

Q. Do you know whose writing that description is in? A. I do not.

Mr. Alva C. Baird: Mr. Machtinger, we offer this as Petitioners' Exhibit next in order.

(Testimony of Gene O. Clark.)

Mr. Machtinger: If the Court please, I object to the admission of this check in evidence; the witness states that the only way he knows that is for the seed wheat, because the check in the description says for seeding wheat; the witness states he does not know whose writing it is, it is a hearsay document and I think improper evidence in this matter.

The Court: Well, I am inclined to agree with you, but I am still going to take it subject to motion to strike or subject to being followed up or both.

The Clerk: Petitioners' Exhibit 33 admitted in evidence.

(Petitioners' Exhibit No. 33 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you a check No. 4606 dated October 17, 1946——

The Court: Let me ask you, do I understand all of these checks were in the hands of your agent?

Mr. Machtinger: I believe that one of our men may have looked at every one of these checks.

Mr. Alva C. Baird: That is correct, your Honor, they spent a day or two days or more in my office going over these checks.

The Court: All right, go ahead.

Q. (By Mr. Alva C. Baird): Will you identify that check, and tell us, if you can, what it was for?

A. For seed wheat.

Mr. Alva C. Baird: We offer this as petitioners' exhibit next in order.

(Testimony of Gene O. Clark.)

Mr. Machtinger: If your Honor please, this check is identical with the previous check. I move on the same basis that——

The Court: Who wrote the words "seed wheat" on this one, if you know?

The Witness: I do not know.

The Court: All right, same ruling.

The Clerk: Petitioners' Exhibit 34 admitted in evidence.

(Petitioners' Exhibit No. 34 was marked for identification and received in evidence.)

The Court: I might also, subject to being followed [359] up, that one of the reasons I am ruling this way, if I ruled them out, we would have an offer of proof that would be twice as long as letting them in. I am trying to be practical about it. Go ahead.

Q. (By Mr. Alva C. Baird): Mr. Clark, I show you Check 4607, dated October 25th, 1946, and ask you, if you can, to tell us what that is.

A. That is \$50 for a salary.

Q. And is that check, and the others to which I have referred, have they been signed by Clyde R. Clark, your father? A. That's right.

Q. Do you know who wrote the pencil notation, salary or labor or whatever it is up here on this check?

A. I believe Joe Acre, the accountant, did that.

Mr. Alva C. Baird: We offer No. 4607 as petitioners' exhibit next in order.

Mr. Machtinger: If the Court please, I object

(Testimony of Gene O. Clark.)

to it on the same grounds as the previous checks, it is drawn by Clyde R. Clark in favor of Clyde R. Clark. There is a word in the description which is identified as salary, it may be salary, but it certainly is not in the same writing as Clyde R. Clark's handwriting. There is no foundation laid that this is a proper check.

The Court: I agree that the witness shows no personal knowledge of it at all, but I am going to let the same ruling [360] apply.

The Clerk: Petitioners' Exhibit 35 admitted in evidence.

(Petitioners' Exhibit No. 35 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): Mr. Clark, I show you Check No. 4608, bearing date, apparently, October 1st, 1946, it is rather blurred and I can't be sure of it, in the amount of \$50 to Clyde R. Clark, and ask you if that was drawn by Clyde R. Clark, your father? A. It was.

Q. And is that the amount of weekly salary that he was being paid? A. It was.

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

Mr. Machtinger: I object to the admission of this check on the same basis as previously—

The Court: Is the word "salary" on there?

Mr. Machtinger: No, sir, there is nothing on this check to identify it for any express purpose.

The Court: Do you have any recollection of that check individually, Mr. Clark?

(Testimony of Gene O. Clark.)

The Witness: I do not. [361]

The Court: Very well, same ruling.

The Clerk: Petitioners' Exhibit 36 admitted in evidence.

(Petitioners' Exhibit No. 36 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): Mr. Clark, I show you Check No. 4609, dated October 18, 1946, payable to Clyde R. Clark, in the amount of \$50, and ask you if that was drawn by Clyde R. Clark on that account? A. It was.

Q. And I notice the notation in the upper left-hand corner, will you tell us what that is and whose writing that is in, if you know?

A. It says "salary", I think that is Joe Acre's writing.

Q. Joe Acre was the accountant?

A. Joe Acre was the accountant.

Mr. Alva C. Baird: We offer that as Petitioners' exhibit next in order.

Mr. Machtinger: If the Court please, I object to the admission of this check on the same grounds as the prior checks.

The Court: Same ruling.

The Clerk: Petitioners' Exhibit 37 admitted in evidence. [362]

(Petitioners' Exhibit No. 37 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4610 dated November 2, 1946, in the amount of \$21 and ask you by whom that check was drawn and

(Testimony of Gene O. Clark.)

call your attention to the notation in the upper left-hand corner, tell us if you can, identify the writing.

A. That is drawn to the North End Service Station, Gas and Oil, for October.

Q. Do you know in whose writing that check is?

A. Yes, sir, Dad's writing, Clyde R. Clark.

Q. Is the notation on the upper left-hand corner in your father's writing, or do you know?

A. It is.

Mr. Alva C. Baird: I offer it as petitioners' exhibit next in order.

Mr. Machtinger: I object to the admission of this check, if the Court please, there is nothing to connect this check with any farm expenses; the witness has not stated that he personally has any knowledge of the gas for which this check was issued.

The Court: Same ruling.

The Clerk: Petitioners' Exhibit 38 admitted in evidence. [363]

(Petitioners' Exhibit No. 38 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4612, dated November 8, 1946, payable to Clyde R. Clark for \$50 and drawn by Clyde R. Clark and ask you if you know what that was for?

A. It doesn't state in the description what it is for, I can only say that as was normal, \$50 a week salary, if that is it.

Mr. Alva C. Baird: We offer that as the petitioners' next in order.

(Testimony of Gene O. Clark.)

The Court: Same objection; same ruling.

The Clerk: Petitioners' Exhibit 39 admitted in evidence.

(Petitioners' Exhibit No. 39 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you a check, No. 4613, dated November 15, 1946, in the amount of \$50, payable to Clyde R. Clark, drawn by Clyde R. Clark on this Special Account No. 1, and ask you if you know what that check was for?

A. \$50, which is his weekly salary, and I would take it to be that. [364]

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 40 admitted in evidence.

(Petitioners' Exhibit No. 40 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4614 in the amount of \$195.57, bearing date in pencil "11/9/1946" and ask you to whom that check was issued, and if you know, for what purpose it was issued?

A. W. A. Thompson, for seed wheat and oats.

Q. Do you know in whose handwriting the check is?

A. That is in Dad's handwriting, Clyde R. Clark.

Q. Is the notation on the upper left-hand corner

(Testimony of Gene O. Clark.)

“for seed wheat and oats”, can you tell us in whose handwriting that is?

A. Yes, that is Dad’s, Clyde R. Clark.

Mr. Alva C. Baird: We offer that as petitioners’ exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners’ Exhibit 41 admitted in evidence. [365]

(Petitioners’ Exhibit No. 41 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4615, dated November 22nd, 1946, for the sum of \$50, payable to Clyde R. Clark, and drawn by Clyde R. Clark, and ask you if you know what that check was for?

A. That is for \$50, and I would take it to be his salary.

Mr. Alva C. Baird: We offer that as petitioners’ exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners’ Exhibit 42 admitted in evidence.

(Petitioners’ Exhibit No. 42 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4616, can you tell us what date that check was issued?

A. March 29.

Q. Is that March or November?

A. November.

Q. Of what year?

A. Of 1946.

(Testimony of Gene O. Clark.)

Q. And do you know in whose handwriting the entire check [366] is?

A. It is in Dad's, Clyde R. Clark's handwriting.

Q. Is the check payable to him and drawn by him on the Special Account No. 1?

A. That is correct.

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

The Court: What is the amount of that check?

Mr. Alva C. Baird: \$50, your Honor.

Q. (By Mr. Alva C. Baird): Do you know what it is for? A. I take it to be a salary.

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 43 admitted in evidence.

(Petitioners' Exhibit No. 43 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4617, dated December 6, 1946, payable to Clyde R. Clark for \$50 and drawn by Clyde R. Clark on Special Account No. 1. I will ask you if you know to whom the check was issued? [367]

A. It is \$50 and I take it to be Dad's salary.

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 44 admitted in evidence.

(Testimony of Gene O. Clark.)

(Petitioners' Exhibit No. 44 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4618, dated December 6, 1946 in the amount of \$36.50, and I will ask you in whose handwriting does this check appear to be, and particularly, can you identify the handwriting in the upper left-hand corner?

A. It's in Clyde R. Clark's handwriting and it's for repairing fences.

Q. The notation "repairing fences, South Farm"—

A. That is correct.

The Court: To whom is it payable?

The Witness: Payable to Clyde R. Clark.

The Court: Do you have personal knowledge of what it is about?

The Witness: I do not.

Mr. Alva C. Baird: We offer this as petitioners' exhibit next in order. [368]

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 45 admitted in evidence.

(Petitioners' Exhibit No. 45 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4619 dated December 6th, 1946, in the amount of \$590.36, payable to A. M. Eckleberry, co-treasurer, and I will ask you if you know what that check was for?

A. That is for taxes.

Q. And for taxes to what?

A. On the farms.

(Testimony of Gene O. Clark.)

Q. On the farms that you owned in Montgomery County, Kansas? A. I owned one of them.

Q. You owned one of them?

A. That is correct.

Q. And this check is to cover the taxes on more than one farm? A. It is.

Q. Now, will you explain that, please, what farms are we now talking about?

A. Dad paid the taxes on both the North and South Farms.

Q. On both the North and South Farms? [369]

A. That is on both my farm and Archie Koyl's farm.

Q. Well, now, if I understand it, this check, then, is in payment of taxes on two different pieces of property in Montgomery County, Kansas. Now, will you state again, just so we will have the record clear, whether or not this involved more than one farm?

A. It involves two farms, both my farm and Archie Koyl's farm.

Q. Do you know how this amount of \$590.36 was to be allocated as between the two farms?

A. We were to each pay our proportionate share, both Archie and I.

Q. Well, do you know what your proportionate share was? A. At this time I do not.

The Court: You don't know how much tax was on either farm, do you?

The Witness: No, I don't.

Mr. Alva C. Baird: I offer this as petitioners'

(Testimony of Gene O. Clark.)

exhibit next in order. We may be able to clear that up.

Mr. Machtinger: I object.

The Court: Objection sustained.

Mr. Alva C. Baird: May I have that marked for identification purpose, your Honor?

The Clerk: Petitioners' Exhibit 46 marked for identification. [370]

(Petitioners' Exhibit No. 46 was marked for identification.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4620 dated December 13, 1946, payable to Clyde R. Clark in the amount of \$50, drawn by Clyde R. Clark, and ask you if you know what that was?

A. I take it to be a salary.

Q. To your father? A. That's correct.

Mr. Alva C. Baird: We offer that as Petitioners' exhibit next in order.

Mr. Machtinger: Same objection.

The Court: Same objection as with respect to those others and the tax check.

Mr. Machtinger: Yes, sir.

The Court: Same ruling.

The Clerk: Petitioners' Exhibit 47 admitted in evidence.

(Petitioners' Exhibit No. 47 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check 4621 dated January 31st, 1947, payable to Clyde R. Clark—this goes to '47.

I will withdraw that last, because my associate

(Testimony of Gene O. Clark.)

called my [371] attention to the fact that it relates to '47. I do not want to get into '47 at this moment.

I show you Check 4603 dated October 11, 1946, payable to Clyde R. Clark for \$50 drawn by Clyde R. Clark on the Special Account No. 1, and ask you if you know what it was for?

A. That is for salary, advance salary.

The Court: You mean, you assume that from the amount of the check?

The Witness: That is written on it.

The Court: By whom?

The Witness: By apparently Joe Acre, the auditor.

The Court: And that is the only reason that you have to say that it is salary then, that it's the amount of salary which your father was drawing?

The Witness: That's right.

The Court: All right, same objection, same ruling.

The Clerk: Petitioners' Exhibit 48 admitted in evidence.

(Petitioners' Exhibit No. 48 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): Mr. Clark, may I ask you whether or not any of the items on the checks which have been introduced in evidence here with reference to this farm, were those items included as [372] deductions on your return for 1946?

A. They were not?

Q. Now, with reference to the year 1947, I will

(Testimony of Gene O. Clark.)

direct your attention to a trip that you made to Kansas some time that year.

Mr. Machtinger: Excuse me for interrupting, if the Court please, if counsel is through with the year 1946, are you going to put on any more about '46?

Mr. Alva C. Baird: I think there might be something that might tie in '46 a little bit, and I would like to keep that open until we have disposed of '47.

Mr. Machtinger: I would like to make it clear we do not waive our rights in regard to the testimony. With the Court's permission, if we can wait until counsel has the opportunity to introduce any more supporting evidence, if he cares, in the year 1946.

The Court: Well, I don't understand you are waiving anything.

Mr. Machtinger: Well, it is understood I do not waive the right to strike.

Q. (By Mr. Alva C. Baird): Mr. Clark, you did make the trip back to Kansas some time this year, did you not? A. I did.

Q. I will ask you whether or not while you were there you [373] made any inquiry of your accountant, Mr. Joe Acre, I believe you have stated his name was, about any memoranda or data that he had with reference to your farming transactions back in these years, '46, '47, '48, and '49?

A. I did.

Q. And I will ask you what you did with reference to whether or not you obtained any data or

(Testimony of Gene O. Clark.)

information from him at that time? I will stop there. A. I did not.

Q. Will you state whether or not you obtained any data or other information from him subsequent to your return to California?

A. Yes, he mailed it to me.

Q. And about when was that mailed to you?

A. The latter part of October—or February.

Q. Latter part of February of this year?

A. This year.

Q. 1955? A. Correct.

Q. Now, I show you petitioners' proposed exhibit next in order—maybe we had better have that marked for identification.

The Clerk: Petitioners' Exhibit 49 marked for identification. [374]

(Petitioners' Exhibit No. 49 was marked for identification.)

Q. (By Mr. Alva C. Baird): I show you Petitioners' Exhibit 49 for identification, and ask you where that came from?

A. That came from Mr. Joe Acre.

Q. When?

A. In February, 1955, this year.

Q. And will you state how Mr. Acre came to send that document to you?

A. Yes. I requested that he send all of the papers pertaining to the farms to me.

Q. And was this particular schedule, Petitioners' Exhibit for identification No. 49, part of the papers that he sent you? A. It was.

(Testimony of Gene O. Clark.)

Mr. Alva C. Baird: Do you have a copy of this, Mr. Machtinger?

Mr. Machtinger: Yes.

Mr. Alva C. Baird: I will say to the Court, that this purports to be an income tax schedule.

The Court: Let me look at it. Did you prepare this yourself?

The Witness: No, your Honor, Joe Acre did.

The Court: As far as you know he did, but do you have [375] any information about it except that it was mailed to you by Joe Acre?

The Witness: Yes, there is some information about it.

The Court: Well, what is the information, Mr. Baird?

Mr. Alva C. Baird: I am trying to find out, your Honor, if you will bear with me just a moment.

If your Honor please, there is no information other than that Mr. Acre did send a small envelope containing that document, and I don't know whether he had these checks.

The Court: What is your position, Mr. Machtinger?

Mr. Machtinger: Do I understand you have offered this in evidence?

Mr. Alva C. Baird: Not at the moment. I have had it marked for identification.

The Court: I thought you were offering it.

Mr. Alva C. Baird: We offer this, if your Honor please, in evidence, as being a statement coming from a certified public accountant employed by Mr.

(Testimony of Gene O. Clark.)

Clark for the purpose of keeping an account of expenditures on his farm operations.

The Court: Will you give your authorities in support of its admissibility?

Mr. Alva C. Baird: I think I have all the authority now that I will ever have.

Mr. Machtinger: If the Court please, I object to the admission of this document. [376]

The Court: Objection sustained.

Q. (By Mr. Alva C. Baird): Mr. Clark, I show you Check No. 4621, dated January 3, 1947, payable to Clyde R. Clark and in the amount of \$50 and drawn on the special account by Clyde R. Clark, and ask you if you know what that was for?

A. I would judge it to be a salary check.

Mr. Alva C. Baird: We offer that as petitioners' exhibit next in order.

Mr. Machtinger: If the Court please, I object to the admission of this check, it is a check drawn by Clyde R. Clark and in favor of Clyde R. Clark, there is no substantiating evidence and there has been no proper foundation laid for the introduction of this document.

The Court: It's drawn on——

Mr. Machtinger: By Clyde R. Clark on the Gene Clark, Inc. bank account in favor of Clyde R. Clark.

The Court: Same ruling. That is, the same ruling as with respect to previous checks in 1946.

The Clerk: Petitioners' Exhibit No. 50 admitted in evidence.

(Testimony of Gene O. Clark.)

(Petitioners' Exhibit No. 50 was marked for identification and received in evidence.) [377]

Q. (By Mr. Alva C. Baird): I show you Check 4622, dated January 6, 1947, in the amount of \$85, drawn by Clyde R. Clark, and ask you if you can tell me to whom the check is made payable?

A. E. Pinchner, it is for overhauling, in the description it states "Overhauling the truck," \$85.

Q. Do you know in whose handwriting this "Overhauling truck, \$85" is?

A. That is in Dad's handwriting.

Q. And do you know what truck this would relate to? A. I would not.

Q. Do you know whether or not on this farm that you had any trucks?

A. I did, I had two trucks.

Mr. Alva C. Baird: We offer this as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 51 admitted in evidence.

(Petitioners' Exhibit No. 51 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4623, dated January 17, 1947 for \$50 payable to Clyde R. Clark, drawn by Clyde R. Clark on Special Account No. 1, and ask you if you can identify that? [378]

A. I would take it to be a salary.

Mr. Alva C. Baird: We offer petitioners' exhibit next in order.

(Testimony of Gene O. Clark.)

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 52 admitted in evidence.

(Petitioners' Exhibit No. 52 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4624 dated January 10, 1947, payable to Clyde R. Clark in the amount of \$50, drawn by Clyde R. Clark, and ask if you can identify that?

A. I would take it to be a salary.

Mr. Alva C. Baird: We offer it as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 53 admitted in evidence.

(Petitioners' Exhibit No. 53 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check No. 4627 dated January 24, 1947, payable to Clyde R. Clark in the amount of \$50, drawn by Clyde [379] R. Clark on Special Account No. 1, and ask if you can identify it?

A. I would take it to be a salary.

Mr. Alva C. Baird: We offer it as petitioners' exhibit next in order.

The Court: Same objection, same ruling.

The Clerk: Petitioners' Exhibit 54 admitted in evidence.

(Petitioners' Exhibit No. 54 was marked for identification and received in evidence.)

Q. (By Mr. Alva C. Baird): I show you Check

(Testimony of Gene O. Clark.)

No. 4628, dated March 26, 1947 in the amount of \$187.89, payable to Clyde R. Clark and drawn by Gene Clark on Special Account No. 1, and ask you if you can tell us what that check was for?

A. In the description it states "To close account."

Q. Do you know whether——

The Court: Don't lead him on it.

Q. (By Mr. Alva C. Baird): What was the proceeds of this check used for, if you know?

A. It is my opinion it was deposited. I take that by Joseph Acre's note.

Q. Can you identify the endorsement on the back of the [380] check?

A. Endorsement is Clyde R. Clark.

Q. Clyde R. Clark.

Mr. A. Baird: Would your Honor pardon me a minute?

Q. (By Mr. A. Baird): Mr. Clark, can you tell us whether or not an account was opened in Independence, Kansas, at or about this time?

A. That is March 26th, 1947?

The Court: Mr. Baird, you are certainly not contending that is an expense check, are you?

Mr. A. Baird: Not up to the moment, your Honor. I am trying to find out what it is.

The Court: All right. Suppose a bank account was opened in Independence and suppose this went into it. Wouldn't you have to prove what came out of it as a basis for the expenses?

Mr. A. Baird: I think that I would, but it—

(Testimony of Gene O. Clark.)

I know that I would have to get it as an expense check, but I am trying to determine whether or not this ties in in any way with other information we had.

The Court: Go ahead.

Mr. A. Baird: May I have this marked for identification? I may be able to make some use of it later.

The Clerk: Petitioners' Exhibit 55 marked for identification. [381]

(The document above referred to was marked

Petitioners' Exhibit No. 55 for identification.)

Mr. A. Baird: Will you mark this for identification, please.

The Clerk: Petitioners' Exhibit 56 marked for identification.

(The document above referred to was marked

Petitioners' Exhibit No. 56 for identification.)

Mr. A. Baird: Mr. Machtinger, you have seen this, have you not?

Mr. Machtinger: Yes.

Q. (By Mr. A. Baird): Mr. Clark, I show you what appears to be an official statement from the Office of the County Treasurer in Montgomery County, Kansas, dated December 3, 1947, and ask you if you can tell us what that is, if you know what property that relates to?

A. Yes, the "Sycamore Township" denotes it is the North Farm.

Q. Now, who owns the so-called North Farm?

A. That was my farm.

(Testimony of Gene O. Clark.)

Q. Was that the farm about which you have been testifying here this afternoon?

A. That is correct. [382]

Q. Can you determine from looking at that document what the amount of taxes for 1947 were?

A. The total is \$223.24.

Mr. A. Baird: We offer that, if your Honor please, as an indication that there was received from Gene O. Clark by the Office of the County Treasurer, Montgomery County, Kansas, taxes in the amount of \$223.24. The witness has stated that relates to the so-called North Farm.

The Court: Is that a bill or a receipt?

Mr. A. Baird: It has marked on the top "Received of Gene O. Clark, \$223.24."

The Court: Does it give the date?

Mr. Machtinger: It says the date is December 3rd, 1947. According to this document, if the Court please, it does not specifically state, to my knowledge, what is set forth and do not understand counsel to say he has a check which purports to be in payment of this notice, if it is such.

Mr. A. Baird: I do not think we have a check, but I will find out.

No, we do not have a check.

The Court: Well, do you know whether you paid these taxes, Mr. Clark?

The Witness: Dad would have paid those, Clyde R. Clark.

The Court: Out of what? [383]

The Witness: Out of the bank account.

(Testimony of Gene O. Clark.)

The Court: What bank account?

The Witness: No doubt be the bank account, Independence State Bank of Independence, Kansas.

The Court: In whose name?

The Witness: In Gene Clark or Clyde R. Clark.

The Court: No incorporated?

The Witness: No, sir.

The Court: Are you offering it, Mr. Baird?

Mr. A. Baird: Yes, I am.

Mr. Machtinger: I understand that counsel is offering it merely to show that there was received of Gene R. Clark, Eugene Clark, the sum set forth on that document as disclosed by the document and nothing more.

The Court: Then I will overrule any objection to this.

Mr. Machtinger: I have no objection, if it is offered solely for that purpose.

The Court: Well, I don't see any need to limit it. It may go to materiality if it is followed up, but, as far as I can see, it is at least admissible in evidence. If there is any evidence that would indicate that somebody else was paying for it, that might be in rebuttal.

The Clerk: Petitioners' Exhibit 56 admitted in evidence. [384]

(The document above referred to heretofore marked Petitioners' Exhibit No. 56 for identification was received in evidence.)

Mr. A. Baird: Now, if the Court please, I renew my offer as to check No. 4619 which has been

(Testimony of Gene O. Clark.)

marked for identification as Petitioners' Exhibit 46, which is the check to the County Treasurer of December 6, 1946, \$590.36, and I will offer it for the purpose of showing that the taxes on this property would be in substantially the same amount as appears on the 1947 receipt a year later, and that we should—it would be fair, it seems to me, and not unreasonable, to make an allocation of that amount of this \$590.36 check that Gene Clark expended.

Mr. Machtinger: If the Court please, I object to the admission of this document. There is nothing whatsoever offered to connect this check with the exhibit introduced by the Petitioner indicating that there was at one time, apparently, a payment to the County Assessor. This is a check made out to Mr. Eckleberry, County Treasurer. There is no indication what it is for. There has been testimony that it may have been on behalf of a third party. There is nothing to indicate how much of it would relate to this Petitioner, if at all, for farm expenses, if there were such expenses.

The Court: I will overrule the objection subject to motion to strike and argument in the brief.

The Clerk: Petitioners' Exhibit 46 admitted in [385] evidence.

(The document above referred to heretofore marked Petitioners' Exhibit No. 46 for identification was received in evidence.)

Mr. A. Baird: That is all of this witness on direct.

Mr. Machtinger: At this time, your Honor, Re-

(Testimony of Gene O. Clark.)

spondent would respectfully move the Court to strike all the check exhibits introduced by Petitioner as not having had a proper foundation laid for admissibility.

The Court: I think you have protected your record sufficiently on that. The rulings will remain as they are up to the moment, which reserves the right to move to strike and to argue in the brief.

Mr. A. Baird: May I ask one further question I neglected to ask?

Q. (By Mr. A. Baird): Mr. Clark, with reference to the year 1947, do you know what——

The Court: Just a minute. Mr. Bryant, you had better wait just about a minute. I was coming around to ask for some information.

Go ahead, Mr. Baird.

Q. (By Mr. A. Baird): Do you know what the expenditures were in the operation [386] of your farm in Montgomery County, Kansas, in 1947?

A. They were approximately \$9,000.

Q. Approximately \$9,000. Now, was any part of that expenditure included in your 1947 return?

A. It was not.

Q. Now, will you explain to the Court how you could have had deductible expenditures of approximately \$9,000 in the year 1947 and not have had it included in your 1947 return?

Mr. Machtinger: I object to that. I think it is drawing an inference.

The Court: I will sustain the objection. I don't know what these \$9,000 expenses were. I do know

(Testimony of Gene O. Clark.)

that the witness, less than a half an hour ago, had a look at a paper which an accountant had mailed which had some such figure in it as a sum total for certain detailed items; whether that was suggestive of the amount in his mind or not, I don't know, but certainly nothing further in that has been said.

Mr. A. Baird: Well, do I understand the Court ruled against his answering the question?

The Court: As put, yes. I don't know whether you have any other questions or not. I am inclined to think that we might recess at this point. [387]

* * * * *

Cross Examination

Q. (By Mr. Machtinger): Mr. Clark, isn't it a fact that except for the descriptive notations on the checks that were handed to you, you have no personal knowledge as to what those checks were drawn for?

A. The \$450, I knew what it was. Dad had drawn that salary for some weeks. I knew about it. The others, I wasn't there; I do not know, you are right.

Q. And isn't it also a fact that you did not know of your own personal knowledge what use was made of the proceeds of those checks?

A. That is correct.

Q. Isn't it also a fact, Mr. Clark, that, except for the— [396] strike that sentence.

Mr. Machtinger: That is all the questions we have.

The Court: Is your father living, Mr. Clark?

(Testimony of Gene O. Clark.)

The Witness: Yes.

The Court: Where?

The Witness: Elk City, Kansas.

The Court: How old is he?

The Witness: 74.

The Court: All right. [397]

* * * * *

[Endorsed]: Filed May 3, 1955.

[Title of Tax Court and Docket Nos. 48336-7-8.]

PROCEEDINGS

Los Angeles, California, March 29-30, 1955

* * * * *

DONALD E. PHILLIPS

was called as a witness by and on behalf of the Respondent, and, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: Donald E. Phillips, 1373 South Ridgeley Drive, Los Angeles.

Direct Examination

Q. (By Mr. Machtinger): Will you state your occupation, Mr. Phillips?

A. I am now a public accountant.

Q. Are you licensed by the State of California?

A. I am.

Q. What background have you had for the pur-

(Testimony of Donald E. Phillips.)

pose of [156] preparation; what preparation have you had for your accounting career?

A. I attended Los Angeles Junior College from 1937 to 1938, Woodbury College from 1939 to 1940, and obtained a degree in accountancy at Woodbury College. Worked for Lockheed Aircraft Corporation as an accountant, United States Army in the supply division, and for the Bureau of Internal Revenue from 1946 until 1943 as an internal revenue agent.

Q. Do you mean from 1946 to 1953?

A. 1953, yes.

Q. What was your position with the Bureau of Internal Revenue?

A. Internal revenue agent, field examiner.

Q. In the course of your occupation with the Bureau of Internal Revenue, did you have occasion to audit the books of taxpayers in order to determine whether or not their income had been properly reported on their returns?

A. Individuals, partnerships, and corporations, yes, sir.

Q. Was that the main bulk of your work?

A. Yes, sir.

Q. While you were employed with the Internal Revenue Service, did you have occasion to audit the books and records of the Gene Clark, Inc. corporation? A. Yes, sir, I did.

Q. Approximately in what year did you start such work? [157]

A. In 1950, approximately September 1950.

(Testimony of Donald E. Phillips.)

Q. In connection with such audit, did you examine all the books and records of the corporation?

A. Yes, sir, I did.

Q. Approximately how long a time did you work in connection with this audit?

A. My final report was submitted in February of 1953, so it covered a period of almost three years.

Q. And in the course of that audit, did you also have occasion to go into the tax returns of Archie and Fawn Koyl?

A. Yes, I did.

Q. In connection with the tax liability of Archie and Fawn Koyl, did you examine their income tax returns for the calendar years 1946, '47, '48 and '49?

A. Yes, sir, I did. [158]

* * * * *

Q. In the course of your investigation of the tax liability of Gene Clark, Incorporated and of the tax liability of the stockholders of that corporation, did you prepare a schedule showing the distribution of unreported constructive dividends to the taxpayers?

A. Yes, sir, I did.

* * * * *

Q. I hand you Respondent's Exhibit G marked for identification. Is this the exhibit that you prepared showing the distribution of unreported constructive dividends?

A. It is. [161]

* * * * *

Q. Did you examine the books and records of the Gene Clark, Inc. corporation for the fiscal years ended April 30, 1947, April 30, 1948, April 30, 1949,

(Testimony of Donald E. Phillips.)

and April 30, 1950? A. Yes, sir, I did. [162]

Q. Did you examine the income tax returns as filed by the corporation for those years?

A. Yes, sir, I did.

Q. In the course of your investigation and examination of the books and records of the corporation, did you attempt to determine whether or not the income as reported on the income tax returns was correct? A. Yes, sir, I did.

Q. As a result of the examination of the books and records of the corporation, did you arrive at an adjustment to net income of the corporation?

Mr. Campbell: Objected to as immaterial.

The Court: Well, I will overrule the objection as to whether he arrived at an adjustment. But when the question is asked as to what the adjustment is, I will sustain the objection.

Q. (By Mr. Machtinger): Can you explain what you did in the course of arriving at an adjustment of net income to the corporation, starting with the fiscal year April 30, 1947? [163]

* * * * *

The Witness: I made a detailed analysis of the bank records of the corporation; that is, all items deposited into the bank accounts, various bank accounts of the corporation, were examined from the original bank deposit slips on file at the various banks. These items of bank deposits were compared to the cash receipts records of Gene Clark, Incorporated in order to verify whether or not all of the

(Testimony of Donald E. Phillips.)

income items were reported. Upon analysis of these records for the four years involved——

Mr. Campbell: I am going to object to his conclusions or what he found. As I understand it, he is confined to what he did.

The Court: Well, he told what he did now. The bank statements aren't in evidence, so that I don't know what they are. I don't know whether they are here or not. I don't know whether the records are here. I assume they are—as to what the books showed as to receipts. But the basis of comparison, so far as I know, isn't here. [164]

Q. (By Mr. Machtinger): In the course of your examination of the corporate records for the fiscal year ended April 30, 1947, did you examine the contract sales of the corporation as disclosed on the books and records?

A. Yes, sir, I did.

Q. Did you examine the tax return filed by the corporation for the fiscal year ended April 30, 1947 with respect to the contract sales, as disclosed by the tax return?

A. Yes, sir, I did.

Q. Did the contract sales, as set forth on the tax return, correspond with the contract sales as set forth on the books and records of the corporation?

Mr. Campbell: Objected to as calling for his conclusion. No proper foundation laid, and immaterial to the issues here.

The Court: Overruled. Answer the question.

(Testimony of Donald E. Phillips.)

A. Yes, sir, they were the same.

Q. (By Mr. Machtinger): From an examination of the books and records of the corporation, did you discover any sales which were not reported on the corporate tax return for the fiscal year ended April 30, 1947?

A. Yes, sir, I did.

Q. Can you state to the Court what composed these contract [165] sales which were not reported by the corporation in its income tax return for the fiscal year ended April 30, 1947?

Mr. Campbell: Objected to as not the best evidence. These are matters which he states are not on the books and records. I would like to know the basis of it.

Mr. Machtinger: That is what he is going to say now as to what sales of the corporation were not reported on its income tax return.

Mr. Campbell: That were on its books and records?

The Court: If Mr. Campbell wants to, I will give him a chance to cross-examine before this witness testifies to it. The indications are that he found something that wasn't on the books. Now, that could mean a great many things, but it also has a possibility of some negative finding. He must have found it out some way, assuming he did find it out. He may have found physical contracts which weren't recorded. He may have gotten admissions or statements; a great deal may have happened. But we are in the dark yet as to how he discovered it, and

(Testimony of Donald E. Phillips.)

until there is some satisfactory basis for that, I don't see how we can allow his conclusions.

Mr. Machtinger: Strike the last question.

Q. (By Mr. Machtinger): Would you state how you discovered that the sales of the corporation did not correspond with the sales reported on the income tax return of the corporation? [166]

Mr. Campbell: That is assuming a fact not in evidence, that they did not correspond.

Mr. Machtinger: I didn't say whether they were in excess or not in excess. He reported that they were not—I mean he testified that they did not correspond.

The Court: Did you discover that there was a difference or not?

The Witness: Yes, sir, I did.

The Court: All right. How did you discover it?

The Witness: The first indication was submitted to me as informant information.

The Court: That is out. We don't want any hearsay from informants. We want to know what you did, what you know of your own knowledge about it.

The Witness: A list of 11 customers of this corporation was given to me, and I checked the records of these 11 customers and found amounts paid by these customers that were not reflected in the records of Gene Clark, Incorporated in either the books or in the income tax returns filed.

The Court: Are those customers here or going to be produced? You know the situation; you have studied it. Now, let's—

(Testimony of Donald E. Phillips.)

Mr. Machtinger: We had originally planned to produce those customers, but when petitioner conceded that there would be fraud, that he would waive the requirement of proof of fraud—— [167]

The Court: Then why are you trying to prove it?

Mr. Machtinger: I am merely trying to show the total additional corporate income—— [168]

* * * * *

Q. Did you study and examine the adjustments made in the statutory notices of deficiency issued to the petitioners in this case?

A. Yes, I did. [169]

* * * * *

Q. (By Mr. Machtinger): Mr. Phillips, you have examined the adjustments made [170] in the statutory notice. Have you prepared a report from which the adjustments in the statutory notice were derived? A. Yes, sir.

Q. Is that report the 30-day letter or the revenue agent's report in connection with the Gene Clark, Incorporated case? A. Yes, sir, it is.

Mr. Machtinger: At this time, Your Honor, I would like to offer in evidence the report prepared by this witness, which is the revenue agent's report on the incorporated case, which discloses the basis for the adjustments in the 90-Day Letter.

Mr. Campbell: To which we object at this time as no proper foundation laid.

No, I will withdraw the objection. I will, in the interests of time, withdraw the objection.

(Testimony of Donald E. Phillips.)

The Court: All right. The objection is withdrawn.

Mr. Campbell: May I see——

The Court: Put them in.

Mr. Campbell: As I understand it, the offer is not as to the truth of the items contained herein, but as to a report which he made which was the basis of the deficiency letter, is that correct?

Mr. Machtinger: That is correct.

I have offered this as the report which the internal revenue agent made, from which the adjustments—— [171]

The Court: It is admitted without objection, considering the statement of counsel, however, reserving the fact that it is not evidence of the truth of the facts, but merely as to the manner in which the calculation was made, and the basis for the calculation.

Mr. Campbell: My understanding, it is offered for that purpose, and I have no objection to it for that purpose.

The Court: I think we understand that.

The Clerk: Respondent's Exhibit A admitted in evidence.

(Respondent's Exhibit A was received in evidence.)

Mr. Machtinger: If your Honor please, we previously offered for identification what was marked Respondent's Exhibit G, and the item which had previously been offered was part of this report that

(Testimony of Donald E. Phillips.)

is now incorporated in this report, as shown to counsel.

The Court: Well, counsel can examine it as closely or otherwise as he cares to. I am not admitting these papers as a demonstration of any facts stated in the revenue agent's report, as to omitted income or anything of that sort. I am admitting it to show that he made his calculation on the basis of these items. [172]

* * * * *

Q. (By Mr. Machtinger): With respect to the notice of deficiency issued to Mr. and Mrs. Koyl which disclosed additional income or set up additional income for the year 1946 for each petitioner of \$9,477.24: Referring you to Exhibit Q of Respondent's Exhibit G, line E, this discloses or sets up a distribution to Mr. Koyl of \$18,954.49 for the year 1946. Is that the adjustment which resulted in the adjustment in the notice of deficiency of \$9,477.24 for each of the petitioners Archie and Fawn Koyl?

A. Insofar as I know, yes.

Q. Is that figure one-half of the \$18,954.49 because of the community property basis of report in California?

A. Yes, and because they filed separate returns.

* * * * * [174]

The Court: There has been nothing except to show how this witness made the calculation, in explanation of the corporate 90-Day Letter. There

(Testimony of Donald E. Phillips.)

is nothing to show that his calculation was correct or was based on fact, and the intimations have been right through this hearing that a settlement was reached on a different basis, at least as to the overall picture. Now, I don't know what this witness knows, although it is beginning to be rather increasingly clear, as far as his own personal knowledge is concerned, he doesn't know anything, and that the facts have not been produced.

Now, I haven't the slightest desire to influence counsel either way. You can press on this within reason as much as you want. It is a matter for you to judge, not me, but it is by no means necessarily to your detriment that these facts are not brought out. If petitioner doesn't want to know what the basis is and wants to face his burden of proof blindly, that is his problem. If you have in your mind in preparing this case circumstances that I don't know anything about, which is not only quite possible but very likely, I never knew [176] anything about this case until I read the pleadings and heard the opening statements—then you go ahead and try to get at it. But you might just as well keep in mind that unless counsel doesn't object, this witness is going to testify only as to facts, and he is not going to supply those facts from hearsay from other people or from preliminary activities on his part.

Q. (By Mr. Machtinger): Mr. Phillips, in the course of your examination of the books and records of the corporation, did you examine the cash

(Testimony of Donald E. Phillips.)

receipts records and the bank deposits of the corporation? A. Yes, sir, I did.

Q. Did you analyze all the bank deposits of the corporation? A. Yes, sir, I did.

The Court: Is that on the corporation's books or through some outside source?

The Witness: I previously answered the question, your Honor, that I examined the bank deposit slips at the various depositories, wherein the corporation maintained their accounts during these years.

The Court: Matters of that sort, bank statements, bank deposit slips, normally are stipulated or at least an effort is made to stipulate them. There usually isn't any doubt about them.

Mr. Campbell: I am not going to raise an objection. [177]

The Court: No stipulation has been here. If counsel doesn't object, go ahead.

Q. (By Mr. Machtinger): Did you reconcile the cash receipts records as against the bank deposits of the corporation?

A. I made a direct comparison between the cash receipts records of Gene Clark, Incorporated and the bank deposit slips at the various banks.

Q. Did you examine the cancelled checks of the corporation? A. Yes, sir, I did.

Q. Did you reconcile those cancelled checks as against the sales records and the cash receipts records of the corporation?

Mr. Campbell: That is objected to. There is no

(Testimony of Donald E. Phillips.)

comparison, as I understand it, to be made from the corporation's checks and cash receipts.

The Court: Cash disbursements perhaps?

Mr. Machtinger: Against the cash disbursements of the corporation and as against the sales records.

The Witness: Will you repeat the question?

(Question read.)

A. I reconciled the cancelled checks or examined the cancelled checks of Gene Clark, Incorporated and compared them to their cash disbursements record. [178]

Q. (By Mr. Machtinger): Did you examine the cash receipts records and reconcile such records with the checks deposited in the bank deposits of the corporation?

A. Yes, sir, I did.

Q. Were the same checks as deposited in the corporation reflected on the cash receipts records?

Mr. Campbell: That is objected to as calling for his conclusion.

The Court: Well, I don't quite follow you on that.

Mr. Campbell: Well, "the same checks," I don't know, unless he examined the original checks which were deposited; I presume he could only examine the amounts of the checks deposited.

The Court: Well, he examined the bank deposit slips, and he determined there were certain deposits. Now, they either compared the cash receipts or they didn't. That is all I understand he is trying to get at.

(Testimony of Donald E. Phillips.)

Mr. Campbell: With that understanding, I have no objection.

The Court: All right. Did you compare them?

The Witness: The items in the bank deposit slips were compared to the items in the cash receipts records of Gene Clark, Incorporated, and they did not always correspond. [179]

Q. (By Mr. Machtinger): In what ways did they not correspond?

A. In that certain deposits had items listed that were not reflected in the cash receipts records.

Q. Did the amounts of the checks which were shown on the corporate books as having been received correspond with the deposit slips of the corporation in the bank accounts of the corporation?

Mr. Campbell: Just a moment. That is assuming that the books of the corporation showed the checks received.

The Court: Well, not necessarily. The witness has already testified that there were some checks in the bank deposits that weren't shown on the books. Now, how much they were and what the circumstances were and so forth, I don't know.

Mr. Campbell: All right, very well.

The Court: Do I understand the witness to say the bank deposits exceeded the cash receipts on the books?

The Witness: No, sir.

The Court: Well, were they less than the cash receipts on the books?

The Witness: They were the same, sir.

(Testimony of Donald E. Phillips.)

The Court: All right. Then let's finish that one mystery. Where did the differences occur?

The Witness: The differences occurred in that items listed in the cash receipts, that I personally looked at the checks in the hands of other people, were not deposited to the [180] bank account of Gene Clark, Incorporated.

The Court: But some other check was deposited?

The Witness: Someone else's check had been deposited in lieu thereof.

The Court: All right. I must say I drew out the answer. Do you object?

Mr. Campbell: Yes, your Honor, I ask the last be stricken.

The Court: About the examination of the books for the other companies?

Mr. Campbell: Yes.

The Court: If you do, I will strike it out.

Mr. Campbell: Yes.

Mr. Machtinger: Is the Court striking out that one part about examining the books of the other companies or this whole——

The Court: I am striking out only the part where he got his information from the books of other companies. He has said that the deposits and the cash receipts equalled each other in amount, that there were differences apparently in the way they were handled, and then he made certain statements as to how he checked those differences, and that part I have ruled out.

(Testimony of Donald E. Phillips.)

Q. (By Mr. Machtinger): Is the substance of your testimony in this respect [181] that the corporation substituted other checks for the ones that were set up on its cash—substituted in its deposits other proceeds than those received? Is the substance of your testimony, Mr. Phillips, that the corporation substituted other receipts for the checks received in payment of corporate sales?

Mr. Campbell: Objected to as assuming a fact not in evidence, and his evidence speaks for itself.

The Court: Well, I agree. If he knows any facts as to substitution of cash or checks or other funds, he can testify to them. If he doesn't he can't.

Mr. Machtinger: He has stated, if your Honor please, that he has examined all the bank deposit slips, that he has examined the checks which were listed as having been received, and that there were other items substituted in place of these.

The Court: The last part he has not testified to. I don't see how the two could equal unless some such thing had happened, but they wouldn't have to be checks. It could have been cash, and there is nothing to show that he knows how it was done, other than his investigation of other people, whose records could be brought here or could have been brought here. Now, if he knows that there was a check of, for illustration, \$1,000 received and recorded on the books, and that the corresponding bank deposit showed \$1,000 in cash, or if he has any way on the basis of his examination of the books

(Testimony of Donald E. Phillips.)

of the company itself to give any such facts, all right. If it is based on [182] investigation of records which are not in evidence and not available, then I am not going to permit him to go into it. Unless he has some specific information, I don't see that it makes any difference anyhow. I realize, or I assume that what you are trying to do is to show that in some manner the actual gross receipts were in excess of the gross receipts recorded on the books. Well, in some respects it has been admitted. But it hasn't been stated in specific amounts or specific items.

Now, this witness either knows them of his own knowledge or from examination of the books of the company or he doesn't.

Q. (By Mr. Machtinger): Mr. Phillips, did you examine the notice of deficiency as issued to Gene Clark, Incorporated? Have you examined the notice of deficiency? A. No, sir.

Q. Do you know whether or not your revenue agent's report relating to Gene Clark, Incorporated was used as a basis for the notice of deficiency issued to Gene Clark, Incorporated?

The Court: He testified once before that it was so used.

Mr. Machtinger: I thought I had limited that question.

Mr. Campbell: As to the individual, your Honor, not as to the corporation.

The Court: I understood—I may be wrong—that it was just the opposite. He testified to it

(Testimony of Donald E. Phillips.)

with respect to the [183] corporation and not the individuals.

Mr. Machtinger: I had thought it was the other way. But I gather, then, that it is to your knowledge that the revenue agent's report that you prepared was used as the basis for the notice of deficiency in both the corporation and the individual case?

Mr. Campbell: Just a minute. I object. He has testified he has never seen the notice of deficiency in the Gene Clark, Incorporated case.

The Court: That is right.

Mr. Campbell: I object to this question. It would be his conclusion, clearly, that it was used as the basis for anything in that report which he hasn't seen.

The Court: Well, it is here; you can still look at it. It still leaves the question of whether the testimony means anything.

Mr. Campbell: If counsel states it is, I will stipulate it is; I will stipulate that it is.

Mr. Machtinger: It is.

Mr. Campbell: All right, I will stipulate.

The Court: It is so stipulated then. Let's move on.

Q. (By Mr. Machtinger): With respect to fiscal year April 30, 1947, can you explain how you arrived at the adjustment in your revenue agent's report from which the notice of deficiency was issued to the [184] corporation?

A. Yes, sir. Upon examination of the contract

(Testimony of Donald E. Phillips.)

sales account, reported in the income tax return of Gene Clark, Incorporated of \$508,258.32, results of my examination disclosed an amount of \$83,960.08 that should have been added to the return.

Q. I am sorry. Should have been added to what?

A. The income reported in the tax return.

Q. Will you explain what facts you took into account in arriving at that figure?

A. Examination of the contract between Truman Johnson on the building of ten houses revealed that there was a contract price of \$330 per house.

Mr. Campbell: Just a minute. I am going to object. This is not responsive to the question. He was asked what he examined to determine it, not his findings.

The Court: Where was this contract, was it in the records of Gene Clark, Incorporated or not?

The Witness: It was in the records of Truman Johnson.

The Court: I will sustain it.

Q. (By Mr. Machtinger): The adjustment of approximately 83,000, to which you just testified, contained any amounts reflected from your examination of the bank deposits as substituted items?

A. Yes, sir, \$14,806.77.

Q. After you arrived at the total amount of additional [185] corporate income in your revenue agent's report, how did you arrive at the amount

(Testimony of Donald E. Phillips.)

that you set up as constructively received by the stockholders?

A. Based upon the stock ownership of Mr. Koyl and Mr. Clark.

Q. Did you reduce the amount of net income by any figure in order to arrive at the amount available for distribution? A. Yes, sir, I did.

Q. What did you take into account in reducing the net income of the corporation in arriving at the amount available for distribution?

A. Federal income taxes accrued upon the liability, additional liability set up from my report.

Q. Is that the figure set up in Schedule Q of Respondent's Exhibit G?

A. No, Exhibit Q was based upon, first, the adjustments to net income of \$102,050.17, \$273.97, other investments, \$36,149.29 of notes receivable, or a total of \$138,473.43, which I reduced by a total amount of \$63,488.47, which was composed of accounting adjustments as listed now, \$6,000, Truman Johnson, \$1,860.40, H. L. Brittain, \$49,210.15, reversal of deferred income method, \$2,714.42 of merchandise purchases disallowed, and \$3,703.50 of bad debts.

Q. After making that adjustment, did you then arrive at the total distribution per RAR? [186]

A. I did. That left a remaining balance of \$74,-984.96.

Mr. Machtinger: Would counsel stipulate that the witness would testify that he went through the same procedure in arriving at the total distribu-

(Testimony of Donald E. Phillips.)

tion per RAR for the years 1947, 1948, and 1949?

Mr. Campbell: I will stipulate that he would so testify. I do not stipulate as to the materiality of it.

Mr. Machtinger: If you would stipulate that he would so testify, then I believe there would be no need to take the witness through each of these computations on that schedule.

The Court: Well, maybe I don't quite understand the point. But there is no use stipulating as to what he would testify unless it is going to come into the evidence. Are you objecting to it coming into the evidence?

Mr. Campbell: No, your Honor, I will not.

The Court: All right. Then we will accept the stipulation.

Q. (By Mr. Machtinger): Mr. Phillips, from the total consideration per revenue agent's report, did you then arrive at the amount that was constructively received by each of the stockholders?

Mr. Campbell: Objected to as calling for his conclusion as to any amounts received by the stockholders.

Mr. Machtinger: I am merely asking him whether he so arrived rather than—— [187]

The Court: But you have got the words "constructively received" in there. I don't know what your basis is for constructive receipt of anything yet.

Mr. Machtinger: I will withdraw that question and rephrase it.

(Testimony of Donald E. Phillips.)

Q. (By Mr. Machtinger): Referring to line E of Schedule Q, entitled "Total Distribution per RAR," what did you then do in computing the amounts that were reflected in the notice of deficiency of each of the stockholders to arrive at the amounts reflected in the notice of deficiency for each of the stockholders?

Mr. Campbell: I will stipulate that he calculated at 70-30 per cent.

Mr. Machtinger: For the years in which there was a 70-30 stock ownership, is that right?

Mr. Campbell: I am referring to that first year, fiscal year 1947.

Mr. Machtinger: All right.

Q. (By Mr. Machtinger): For years subsequent to fiscal year 1947, Mr. Phillips, did you then make a comparable distribution on the basis of percentage of stock ownership? A. Yes, sir, I did.

Q. Is it from the resulting figures of amounts distributed per your revenue agent's report that the notices of [188] of deficiency were prepared, is that correct?

A. Insofar as I know, they were. [189]

* * * * *

Cross Examination * * * * *

Q. (By Mr. Campbell): Now, let us take, for a moment, the question of these items which you have referred to or counsel has referred to as substituted items, and you have there, have you not, a schedule with respect to the fiscal year 1947?

A. Exhibit A.

(Testimony of Donald E. Phillips.)

Q. How many pages do you have of that? [190]

A. Ten.

Q. Ten pages. Are those all with relation to the fiscal year 1947? A. Yes, sir.

Q. Or is that for all years? 1947?

A. 1947.

Q. Now, isn't it a fact, Mr. Phillips, that deposits were made in the corporation accounts of amounts totalling the exact amounts of the items which you have set forth in that exhibit?

A. In the corporation bank accounts? Yes, sir. These items were deposited in the corporation bank accounts.

Q. And those items which you have set forth in that exhibit and which you have also set forth in the body of your report and carried over into the deficiency letters, were in fact reported on the corporation return, were they not?

A. Not as income, if you consider that your income comes from the cash or the contract sales account.

Q. No, sir, that isn't what I asked you. I asked you if it isn't a fact that these specific items that you have set forth in your report as unreported were in fact reported on the corporation return?

Mr. Machtinger: Would counsel identify which column of specific items to which he is referring in Exhibit A that he has directed the witness' attention to? [191]

Mr. Campbell: I am referring to the column

(Testimony of Donald E. Phillips.)

of amounts which is headed here, "Unreported Item of Income."

Q. (By Mr. Campbell): Now, those specific items were in fact reported on the corporation return, were they not?

A. I couldn't answer that question as yet, Mr. Campbell, for the reason that in my opinion it is the sales record that is the record that says what is reported.

Q. Well, let's go back just a minute, Mr. Phillips. It is a fact, is it not, that all of these items set forth on this report were deposited in the corporation's bank account, is that right?

A. Yes, sir.

Q. And it is a fact, is it not, that the amounts deposited in the bank were reported in the gross sales of the corporation, is that not true?

I will reframe the question.

It is a fact, is it not, that all of the items which were deposited in the bank account of the corporation were reflected in the corporation tax returns?

Mr. Machtinger: I object to that question. The word "reflected" is something that I don't think the witness can properly answer.

The Court: It is a little bit vague, Mr. Campbell. What you were asking him before, as I understood it, whether all of the amounts deposited in the bank were included in gross [192] receipts on the return.

Mr. Campbell: Well, I amended it because some deposits in the bank would be in a different cate-

(Testimony of Donald E. Phillips.)

gory. But I will come back to these deposits.

Q. (By Mr. Campbell): Were not the deposits of the sums set forth in this schedule in the bank accounts reported in the sales of the corporation?

Mr. Machtinger: If your Honor please, I object to that unless the counsel specifically states whether he is referring to both the deposits under the heading "Unreported Item of Income" and the deposits entitled "Amount of Deposit" in the column 2.

Mr. Campbell: I think my question is clear to the witness.

The Court: I would think so. Let's at least find out. It may be necessary to go a little bit further.

The Witness: May I answer this to a specific, particular item?

Mr. Campbell: No, sir. I wish you would answer my question as a whole if you can.

Mr. Machtinger: If it is necessary for the witness to illustrate the answer, can he be so permitted?

The Court: You will have him on redirect. You can let him give all the explanations that are material to Mr. [193] Campbell's questions. But I think this witness knows what is in the return and knows what he put down as unreported items, and he knows whether they were in there and probably what slots they were in, if they were, and he knows as to the extent, if any, to which they weren't in there. I think he can explain it.

A. The amounts there are the amount deposited

(Testimony of Donald E. Phillips.)

to the bank accounts of the corporation. But in my opinion they were not reported as income to the corporation.

Q. (By Mr. Campbell): I am not asking you for your opinion. I am asking you if these specific amounts which went into the bank account were in turn reported on the income tax return?

A. No, sir, they weren't.

Q. Will you indicate to me on these 10 pages how many of these items—and enumerate them—that were deposited in the bank accounts were not reported on the return?

A. Insofar as I know, all of the items therein listed were not properly identified in the sales records, and that allowances were made in every instance where there was no identification.

Q. Now, Mr. Phillips, let's see if we can get together on the question and answer.

As I understood your testimony, every one of these items which you have picked up here, you picked up from the corporation's records, is that correct? [194]

A. That's correct, sir.

Q. And every single one of these items went into the bank account of the corporation, is that correct?

A. That's correct, sir.

Q. And is it not true that the bank account of the corporation was fully reflected in the return filed by the corporation?

Mr. Machtinger: I again would have to object to the word "reflected." It could be reflected by being admitted from the corporation——

(Testimony of Donald E. Phillips.)

Q. (By Mr. Campbell): Presented in the return? A. Yes, sir.

Q. All right. Now, we have got a further basis to deal on. Now, as I understand your testimony, though, you say that there were some items that you found in the sales receipts on a particular day which do not correspond with a particular check which was deposited, is that right?

A. That's right, sir.

Q. Now, isn't it a fact, did you not discover during the course of your examination that the corporation cashed many accommodation checks for customers?

A. I didn't discover this in my examination, no, sir.

Q. I asked you if you did not discover the fact, if you were not advised of the fact that the corporation cashed many [195] accommodation checks for their customers?

A. I was advised that that was true.

Q. All right. And were you not advised by the various employees whom you interviewed that checks were regularly cashed for the cleaning establishment, for the convenience of the cleaning establishment, which was located next door to the plumbing shop in El Monte?

Mr. Machtinger: I object to that question, your Honor. It goes into facts which are very vague and general as to whether or not he was advised as to many checks, and by the cleaning establish-

(Testimony of Donald E. Phillips.)

ment. These are things which petitioner can bring out himself.

The Court: He has brought up a lot of unreported items. All he is being asked is whether he was advised about cashing checks. That doesn't mean he accepted the advice as true. You wanted to bring out how he made these calculations, and that is all we are getting at. There has been no evidence in the case of any such cashing of checks, and I don't know where at the moment it is going to. But the fact that he was advised that they had cashed one or 10,000 checks doesn't mean that they did it.

Q. (By Mr. Campbell): Were you so advised?

A. Yes, sir, I was so advised.

Q. And did you make any investigation to determine the [196] truth of the advice which you received in that connection?

A. No further investigation than a request to the same people to furnish me some information to that effect.

Q. Did you interview the cleaning establishment which it was told you that checks were cashed for?

A. No, sir, I did not.

Q. You simply asked for further proof, as I take it, and I take it further that no such proof was forthcoming while you were there, is that right?

A. That's right.

Q. Now, with respect to these various checks which you have listed here as being unreported

(Testimony of Donald E. Phillips.)

income—and you listed them as unreported income from cash sales, did you not?

A. I believe from substituted items.

Q. All right.

A. You have my copy of the report.

Q. Now, isn't it a fact——

Mr. Machtinger: I am not sure the witness finished his answer.

The Court: I think, Mr. Campbell, that you have——

The Witness: I think you have misappropriated——

Mr. Campbell: Pardon me. I didn't mean to carry it away.

The Witness: My heading of the exhibit is "Unreported Income Determined from Substituted Items in Bank Deposits." [197]

Q. (By Mr. Campbell): And as I take it, the basis of your heading and of your placing these matters in this report in this manner was from the fact that you did not find sales tickets where these particular checks were listed, is that right?

A. That's right, sir.

Q. And as I gather, what you are trying to say is, and the effect of your testimony—correct me if I am wrong—is that these items were reported, but that in your opinion similar items were not reported, is that right?

A. No, sir. It is my contention that the fact that they go into the bank does not mean that they are the reported sales. The reported sales are

(Testimony of Donald E. Phillips.)

those that are listed in the sales register, sales journal, or whatever accounting document the company might have.

Q. You reconciled the reported sales to the bank account, did you not; is that correct?

A. Yes, sir.

Q. And you found that they were in harmony, did you not?

A. In total amounts, that is correct, sir.

Q. So that any statement of unreported sales, and as to these items, was simply a conclusion which you drew, is that right?

A. Possibly it is only a conclusion, sir, but the cash receipts did not match the items in the bank deposit. [198]

Q. When you say they did not match the items in the bank deposit, you mean by that that you did not find an individual receipt in the exact amount of these particular checks, is that right?

A. That's right, sir.

Q. And did you make any investigation to determine whether or not some of these checks had been received in situations where a customer would receive some change back from his check?

A. I made whatever investigation was possible, sir.

Q. I didn't ask you that, sir. I asked you if you made any investigation. Maybe you concluded that none was possible. But did you make any investigation of that?

(Testimony of Donald E. Phillips.)

A. I made a detailed itemized list of all of the sales reported by the corporation, sir.

Q. Did you make any investigation to determine, for example, if a customer would come in and buy \$25 worth of merchandise and either write and cash a \$35 check or turn in a pay roll check for that amount, and receive the balance in cash?

A. No, sir, I did not.

Q. And, as a matter of fact, some of these items which you have listed here are such things as postal notes and money orders and travelers' checks, are they not? A. Yes, sir.

Q. And it would be an odd coincidence if the amount of a cash purchase of plumbing supply equalled the exact amount, for [199] example, of a travelers' check, isn't that correct?

A. That's correct, sir.

Q. Now, as to these ten sheets which comprise Exhibit A, and all of which refer to the year 1947, with the exception of travelers' checks and postal money orders, you had the clearing number of each check, did you not? A. Yes, sir, I did.

Q. And did you ascertain the maker of these checks and for what purpose these checks were made? A. No, sir, I did not.

Q. Did you at the time make any attempt to ascertain if, simultaneously with these items, there was withdrawn from inventory, merchandise?

A. No, sir, I did not.

Q. And would your testimony be the same as

(Testimony of Donald E. Phillips.)

to each of the years here involved with respect to this type of item?

A. No, sir, it would not.

Q. In what respect would it vary as to any year?

A. In Exhibit E there are several identified items as to the third party.

Q. What page is that of your report?

A. Page 59 is where the schedule—60.

Q. To what year does that refer?

A. That is to the year ended April 30, 1948.

Q. All right, sir. And how many pages of items are [200] there with respect to that year?

A. Five pages, sir.

Q. Out of those five pages of items, you say that some of them were identified?

A. Yes, sir, they were.

Q. You say five items?

A. Five pages, I said.

Q. How many items? A. 19 items.

Q. Now, with respect to those 19 items, were those items reported in the corporation return?

Mr. Machtinger: If your Honor please, counsel could be more specific in that question as to whether or not he is asking the witness whether those items were included in the corporate income as reported on the return. Is that the substance of your question?

Mr. Campbell: Yes, yes. That is the purport of my question.

A. No, sir, they were not.

(Testimony of Donald E. Phillips.)

Q. (By Mr. Campbell): Were similar items reported on the return? A. Yes, sir.

Q. What were the similar items?

A. In regard to the deposit of December 10, 1947, total amount of \$16,851.59, included therein was a Rucklos & Company [201] check in the amount of \$6,550.

Q. That is one of the items which you have on this schedule? A. Yes, sir.

Q. And the amount of \$16,851.59 was carried into the gross sales of the corporation for that year?

A. Yes. And included in the schedule of sale of assets was an amount of \$6,550 less \$1,435.41.

Q. So that that amount was placed in the bank?

A. The total amount of \$6,550 was, yes, sir.

Q. And what was the total amount of the Rucklos check? A. \$6,550.

Q. And that was reported on the return?

A. No, sir.

Q. Well, now, weren't all those bank deposits—the bank deposit of \$16,851.59, which included this Rucklos check—reported on the return?

A. There is no line on an income tax return for the total of the bank deposits to be reported, Mr. Campbell.

Q. I understand, but weren't the bank deposits carried directly—those relating to sales—carried in the company's books under the heading of sales, and reported in the return?

(Testimony of Donald E. Phillips.)

A. As I said, sir, that particular sale is reported in the schedule of a sale of assets.

Q. I see, and was reported on the return? [202]

A. In an amount less than \$6,550. It was reported in an amount of 5,000.

Q. Was the balance reported in sales?

A. No.

Q. If you know? A. No, sir, it was not.

Q. And is that the only item to which you can call attention in that five pages? Before you go from that item, did you determine who, if anyone, got the proceeds of that, specifically?

A. No, sir, because that amount did go into the bank account of Gene Clark, Incorporated. But I could give you the detail of the cash receipt for which there was no deposit made.

Q. Did any of the stockholders withdraw that amount from the bank? A. Not as such, sir.

Q. All right. What other item have you got out of these five pages?

A. Included in June 20, 1947, a total deposit of \$11,813.24, the Hamilton Homes, Incorporated check number 1385 in the amount of \$2,445 was deposited.

Q. Was it reported in sales?

A. No, sir, it was not.

Q. Well, was that a substituted item, then?

A. Yes, sir, it was. [203]

Q. What was it substituted for?

A. In part, for a Charles Hasekian check of \$1,900.

(Testimony of Donald E. Phillips.)

Q. And what else?

A. And in part for cash receipts 4622, 4625, 4626, and 4627 of Gene Clark, Incorporated. Do you want the details on the names?

Q. Were these other receipts carried in the gross sales of the corporation?

A. Yes, sir, they were. And I did not add them to income.

Q. All right. Now, how many other items have you got in fiscal '48?

A. Hamilton Homes, Incorporated check number 1436, included in the deposit of July 30, 1947 in the total amount of \$10,016.46; that check in the amount of \$2,170.

Q. And that was not reported in sales?

A. No, sir, it was not.

Q. All right. Now, let me ask you this with regard to the fiscal year ending April 30, 1948. You testified, I believe, that the basis of your computation was simply on the basis of stock ownership. Did you make any determination in that regard as to when, if at all, Mr. Koyl ceased to be active in the corporation?

A. Yes, sir, I did, in that I treated the dividends as liquidating dividends upon the sale of his stock.

Q. Now, it is a fact, is it not, that the actual transfer [204] of his stock came sometime before the end of the fiscal year, isn't that right?

A. Yes, sir.

Q. But you continued to treat items on your constructive dividend basis as being divided to

(Testimony of Donald E. Phillips.)

Koyl right up to the end of the fiscal year, didn't you? A. Yes, sir.

Q. So that, actually, some of these transactions which you have related to Koyl in your workup of this matter occurred at a time when he was not a stock owner, is that right? A. Yes, sir.

Q. Now, in that connection, and with regard to these so-called constructive dividends for these two years or for the subsequent two years, did you make any effort to ascertain if, in fact, any of the sums which you have set up as constructive dividends were actually physically received by any of the stockholders?

A. Yes, sir, we traced them into their bank accounts.

Q. Let us go back to Exhibit A. What, if any, of those sums did you trace into Mr. Koyl's bank account? I understood you to say they went to the corporation bank account.

A. Those sums did, sir.

Q. And did any of those sums in Schedule A go into Mr. Koyl's bank account? A. No, sir.

Q. Did any of these sums set forth in these schedules, now, with respect to the so-called substituted items, referring now to specific items that you have set out in these schedules, go into Mr. Koyl's bank account?

A. None of the things from the substituted item schedules could have gone in any other bank account than the corporation bank account.

(Testimony of Donald E. Phillips.)

Q. Did any of them go into Mr. Clark's bank account? A. No, sir.

Q. They all went into the corporation bank account, didn't they? A. Yes, sir.

Q. And they were all treated as corporation funds at all times, weren't they?

A. Yes, sir.

Q. So that, so far as all of these items themselves are concerned, these are not as you—set forth in your report, unreported items of income; isn't that right?

A. They are, as I stated, sir, in my report, they are substituted items.

Q. These were items of reported income, isn't that right?

A. They are not listed in the sales records.

Q. Isn't it a fact that the corporation tax returns show a reconciliation with the books? Are you familiar with that?

A. Yes, sir, they do reconcile to the books. [206]

Q. And included in that reconciliation with the books is reconciliation with the corporation bank account, isn't that right? A. Yes, sir.

Q. Included in that corporation bank account are these various items, isn't that right?

A. Yes, sir.

Q. All right. Now, as I understand you, in computing what you determined to be the amount of constructive dividends specified by the stockholders, you took into account accrued Federal income tax, is that right? A. Yes, sir.

(Testimony of Donald E. Phillips.)

Q. Did you take into account accrued State income taxes? A. No, sir.

Q. Did you take into account accrued State sales taxes? A. No, sir.

Q. With respect to the fiscal year ending April 30, 1949, how did you treat the division of these so-called unreported or substituted items?

A. For the year ending April 30, 1949?

Q. Yes.

A. The total amount of dividends available of \$27,437.93 were distributed.

Q. How did you divide it among the stockholders?

A. \$26,233.75 to Gene Clark; \$1,204.18 to Archie Koyl. [207]

Q. And was that on the basis of the change in stock ownership in January of 1949?

A. Yes, sir, it was.

Q. You took it into consideration, then, that at the time that Clark sold out to Koyl before the end of the fiscal year, although you had not taken it into consideration at the time that Koyl sold out to Clark before the end of the fiscal year; is that right?

A. Actually, it was taken into consideration in the other one, in that the dividends declared after Mr. Koyl was out of the corporation by Mr. Clark were taken away from the amount allowed against earned surplus in the previous year—

Q. You charged him with dividends after he left there, didn't you?

(Testimony of Donald E. Phillips.)

A. They were constructively received in the prior year.

Q. You say—well, let's go on with this matter of constructively received. Now, you must have worked out somewhere how much cash or property Mr. Koyl or Mrs. Koyl received. You have any schedule on that? A. No, sir, I do not.

Q. Did you make up such a schedule as to what they actually received?

A. We made an attempt at that, yes, sir.

Q. Well, do you have those papers with you here?

A. I do not at this moment, sir. [208]

Q. Can you produce those papers?

Mr. Machtinger: If your Honor please, the use of "constructively received" has been from the corporation and not from other sources. If counsel is asking the witness as to the constructive receipts of unreported income of the corporation, the witness has before him his working papers, and that has been the content of his testimony up until now.

Do I understand that you are departing then from the corporate, constructive receipt of corporate income?

Mr. Campbell: I am trying to find out—he allocated these as constructive dividends to the petitioners in this case—I am trying to find out, aside from constructively, what they actually received. This man made the investigation.

Mr. Machtinger: Are we off now from the receipt of the corporate income? That is the point.

(Testimony of Donald E. Phillips.)

Mr. Campbell: By this question, yes.

Mr. Machtinger: We don't have in issue right now, do we, whether or not the petitioners had assessed against them or had deficiencies asserted against them because of their receipt of items other than from the corporation?

Mr. Campbell: I am trying to see what they received, other than from the corporation or anywhere else that this agent found.

Mr. Machtinger: I don't see where you have made the question relevant to the issue that we have before us now. [209]

Mr. Campbell: If the Court please, I understand the issue before the Court is what Archie and Fawn Koyl received. The allegation and the proof offered here and as set forth by the Commissioner in his letters is that they received certain dividends from the corporation, as well as other sums, as set forth in the 90-Day Letter. Now, I am trying to ascertain how these dividends were paid.

The Court: Are you talking about regular or constructive dividends?

Mr. Campbell: I will ask a question as to that.

Q. (By Mr. Campbell): Were any regular dividends declared?

A. Only one, in the amount of \$20,000.

Q. And that was at a time when Gene Clark was a sole owner of the corporation?

A. Except for one qualifying share.

Q. Except for one qualifying share, and that

(Testimony of Donald E. Phillips.)

was not at a time that Mr. Koyl was connected with the corporation? A. That's right.

Q. And that \$20,000 was paid to Mr. Clark, was it not, or for his benefit? A. \$19,996.17.

Q. At any time that Mr. Koyl was connected with the corporation, was there a regular dividend declared? A. No, sir. [210]

Q. And all of the other items that you have set forth as dividends received by him from the corporation are what you have referred to as constructive dividends, aren't they? A. Yes, sir.

Q. Did he actually receive those in cash or property?

Mr. Machtinger: I object to that question. The witness has testified as to the basis on which he prepared his report, setting forth the amount of additional dividends to the stockholders on the basis——

The Court: He hasn't said yet what he means by constructive dividends. I think it is about time he was saying so.

Q. (By Mr. Campbell): What do you mean by "constructive dividend"?

A. Moneys available to the stockholders of the corporation that they have taken for their own uses.

Q. So that you include in the words "constructive dividend" money which they have taken, is that correct? A. Yes, sir.

Q. And that exclusively, money which they have taken, is that right?

A. Money and property.

Q. Which they have taken? A. Yes, sir.

(Testimony of Donald E. Phillips.)

Q. Now, I want to know what money and property Mr. Koysl took, based on your examination of these corporate records. I [211] would like to know the specific sums and the times, specific assets. Can you give me that?

A. I couldn't give it to you at this time, sir. I'd have to go through my work papers.

Q. Do you have anything in connection with that?

A. I have detailed analysis of his bank accounts.

Q. Yes.

A. And the names of the various items and things in their bank accounts.

Q. You have been here in court through this proceeding, have you not? A. Yes, sir.

Q. Have you examined the schedules which have been placed in evidence here as Petitioners' Exhibits 9, 10, 11, and 12? Have you examined those?

A. I have read those schedules.

Q. All right. Can you tell me anything, purport to set out certain moneys or assets of the corporation which Mr. Koysl received, in addition to those set forth in his returns? Now, I want to know if you can point out to me any other money which he received from the corporation by way of what you call a constructive dividend?

A. As an accountant, I have not had an opportunity to see if those schedules are correct, sir.

Q. Well, let's forget the schedules. What schedules have [212] you got on it?

Let me ask you this: I will withdraw the last

(Testimony of Donald E. Phillips.)

question. Your 30 percent is simply a formula, isn't it?

A. Yes, sir, it is.

Q. And it is not based on any actual receipt of money by Mr. Koyl, is it?

A. No, sir. By the nature of this case, I was unable to determine actual amounts.

The Court: It is 30 percent of what?

Mr. Campbell: I didn't get your Honor's question.

The Court: I say, it is 30 percent of what?

The Witness: The stock ownership.

The Court: I know that. But I mean, you have been talking about constructive dividends. You apparently mean actual dividends, though undeclared dividends, and apparently there is some cash represented and some property represented, and you attributed 30 percent to Mr. Koyl and 70 percent to Mr. Clark?

The Witness: Yes, sir.

The Court: Now, 30 percent of what and 70 percent of what? What money are you talking about? What property are you talking about?

The Witness: My Schedule Q, your Honor; I took the adjustments to net income in each of the years to the corporation, reduced by accounting adjustments that were not available, [213] and had total distribution figure, and then the year ended April 30, 1947, it was \$74,984.96.

The Court: Aside from the question of the amounts for the moment, does the cash part that you have allocated represent what you correctly or

(Testimony of Donald E. Phillips.)

not are characterizing as unreported income, or isn't it? Unreported corporate income?

The Witness: It is unreported corporate income.

The Court: You said some part of it was property. You certainly should be able to tell us specifically what that is.

The Witness: In the first year it consisted of the Kansas farms.

The Court: All right. What other property?

The Witness: In the second year, this report contained some assets distributed.

The Court: What do you mean by assets distributed?

The Witness: It consisted of some assets that were supposedly sold, according to the records, to some third party, but in fact the assets were distributed in kind to the officers, the stockholders.

The Court: What type of assets were they?

The Witness: They were trucks and automobiles, your Honor.

The Court: By that you mean that the title was transferred to the officers? [214]

The Witness: Stockholders, yes.

The Court: Is there anything else except the farms and the assets that you are talking about that was distributed in kind?

The Witness: Only the distribution of the personal residence to Gene Clark, the Truman Johnson \$6,000 outside of escrow amount.

The Court: You include in this constructive dividend setup the forty-odd hundred dollars that Mr.

(Testimony of Donald E. Phillips.)

Koyl said was—represented work done on his house by somebody who owed the corporation some money, where that debt was cancelled?

The Witness: Not as a specific item, your Honor.

The Court: I see. Well, except for properties which you have mentioned and everything else that you referred to as a constructive dividend, the explanation in your mind is that it was unreported corporate income which, not having gotten into the corporate coffers, went to the stockholders on a 70-30 basis, is that correct?

The Witness: Yes.

The Court: All right.

Have you just a few questions?

Mr. Campbell: No, I have several questions, your Honor.

The Court: Well, we have a few minutes. Maybe we can ask one of them, anyhow. [215]

Q. (By Mr. Campbell): You referred to some cars and trucks transferred to officers or stockholders in the second year. Was that in the fiscal year 1948, ending April 30, 1948?

A. Yes, sir, it was.

Q. To whom were those cars and trucks transferred?

A. I better say I can't remember, sir, because I can't.

Q. Weren't they paid for?

A. In the records of the corporation, they were paid for at book value, I believe, depreciated book value.

(Testimony of Donald E. Phillips.)

Q. But you don't recall what officer or stockholder received those, is that right?

A. I don't want to answer your question incorrectly, and I can't remember at this time.

Q. Do you have anything you can refer to to refresh your recollection? A. Yes.

Q. Will you do so?

Now, you referred to distribution of property, of Kansas farms. It is a fact, is it not, and your investigation disclosed, that they were carried as an asset on the books of the corporation; is that right?

A. Yes, sir, they were.

The Court: Under what heading were they carried as assets of the corporation? [216]

The Witness: Notes receivable, I believe, from the officers.

Q. (By Mr. Campbell): The notes receivable represented the corporation's investment, the amount of money that was taken out of the corporation in that regard? A. Yes, sir.

The Court: Well, I'd like to get that clear. As I understand it, then, the properties were not carried on the books of the corporation, but notes receivable growing out of the transactions with respect to the properties were carried on the books; is that correct?

The Witness: Yes, sir. [217]

* * * * *

Q. (By Mr. Campbell): Just before the recess yesterday afternoon, you stated that you had worked up some kind of a schedule showing the

(Testimony of Donald E. Phillips.)

cash or other assets received by Mr. Koyl. Do you have such schedule? A. No, sir, I do not.

Q. Do I take it that you did not work up such a schedule?

A. Not a particular schedule. I only had the bank deposit items to his various bank accounts.

Q. All right. We will come to those in just a moment. Incidentally, were the bank deposit items you are referring to, the items in your report whereby you added to corporation income all deposits to the accounts of Archie and Fawn Koyl; isn't that correct?

A. I did not add all deposits.

Q. With certain exceptions?

A. With certain exceptions, yes, sir.

Q. All right. Now, let's go back a moment or two on this matter of what you have referred to as substituted items, and I believe we were examining the year 1948 in your schedule, which [221] consisted of some five pages of items, four or five of which you said you had identified, is that correct?

A. I believe it was 19, sir.

Q. 19, all right. Well, let's take an example of your items which you have identified. For example, let's turn to the schedule and to page 63 of your report, and one of the items which you have identified is that of Pacific Pumps, Incorporated; is that correct? A. Yes, sir.

Q. And as you have it listed here, you say, "Unreported Item of Income, \$1,094.52." Do you observe that item? A. Yes, sir.

(Testimony of Donald E. Phillips.)

Q. Now, it is a fact, is it not, that that \$1,094.52 was set forth in the corporation books, isn't that true? A. Only in the bank deposits, sir.

Q. Well, let's see if we can trace this item through. Referring now to the cash received record of the corporation, page 73, and to the next to last item on that page where there is listed the item "E. J. Weiss, \$1,094.52," that is the same item, is it not? A. Yes, sir, it is.

Q. E. J. Weiss was president of Pacific Pumps, is that correct? A. I don't know that, sir.

Q. All right. But that is the same item that you have [222] referred to in your accounting as being an unreported item of income? A. Yes, sir.

Q. And that is listed there as a credit to accounts receivable and a charge to net amount received and deposited, is that correct?

A. Yes, sir.

Q. And that was carried into the bank account, was it not? A. Yes, sir.

Q. Will you refer to the sales journal in that same book and to page 68 thereof?

Mr. Bryant: For the record, what was the last page the witness was referring to?

Mr. Campbell: Page 73.

Q. (By Mr. Campbell, continuing): Page 68 of the sales record, and I will ask you if you do not find that the same item is listed thereon?

A. I do, sir.

Q. And will you point the item out to me? It is about the tenth item down, is it not?

(Testimony of Donald E. Phillips.)

A. Yes, sir, it is.

Q. And it is there debited to accounts receivable and credited to sales plumbing, is it not?

A. Yes, sir, it is. [223]

Q. And is a part of the total of sales for January 1948 of \$40,913.50, as shown at the bottom of that page; is that correct? A. Yes, sir.

Q. That is the figure which was carried as a part of the item of sales, as set forth in the corporation's income tax return for that period, is it not?

A. Yes, sir, it is.

Q. So that, as to that item, that specific item which you have identified was reported in the income tax return of the corporation, was it not?

A. Yes, sir, it was. But it was incorrectly labeled as being received from Mr. Weiss, because it was not.

Q. From whom was it received?

A. Pacific Pumps.

Q. Mr. Weiss is president of the Pacific Pumps, is he not? A. I do not know that, sir.

Q. Well, that is the same item of \$1,094.52 which you say is unreported, is it not?

A. I did, sir, in my report.

Q. All right. Now, with regard to the year 1950, fiscal year, how many pages in your report of these so-called substituted and unreported items of income are there? That is, I believe, pages 77 to—

A. Two pages.

Q. And what are the pages in your report?

A. 77 and 78.

(Testimony of Donald E. Phillips.)

Q. And how many of those items did you identify? A. One, sir.

Q. It is a fact, is it not, that in that year and as in prior years, all of these items were deposited in the corporation's bank account?

A. Yes, sir.

Q. And the total receipts of the bank account correspond with the sales as recorded in the company's books?

A. They coincide with the cash receipts.

Q. Coincide or correspond, whichever word you want to use; and were reported in the corporation's tax return, is that correct?

A. Not as these specific sales.

Q. In a similar amount?

A. In a similar amount, yes, sir.

Q. Those sales are specified in—the particular sales are specified in the return, are they?

A. No, sir, they are not.

Q. Now, do you have a list or a schedule of the items for which you state these were substituted?

A. Yes, sir, I do.

Q. Will you produce that? [225]

A. For the year 1950, sir?

Q. Do you have it for all four years?

A. Yes, sir, I do.

Q. Is that a part of your report?

A. No, sir, it is not.

Q. And it was not used, as I take it, then, in setting forth the matters that were set forth in the assessment letter here?

(Testimony of Donald E. Phillips.)

A. It was used as my work papers, from which this report was prepared.

Q. Do you have those schedules before you?

A. Yes. This is 1948.

Mr. Machtinger: May I see the schedules?

Will counsel ask the witness to identify specifically the schedules to which we are now referring?

Mr. Campbell: Yes, I will mark them in just a minute, Mr. Machtinger.

Q. (By Mr. Campbell): You have produced here some four schedules consisting of a large number of work sheets. Are these the sheets which you state contain the items of sales which were not reported in the returns? A. Yes, sir.

Q. And these are not the same items which you have listed in your revenue agent's report as being the unreported items, is [226] that correct?

A. In the legend in these on the right side, with the "U," the ones with the "U."

Mr. Machtinger: Will you speak louder?

The Witness: The ones with the "U" after them are the ones that are included in my report.

Q. (By Mr. Campbell): Well, in order that I may understand this, will you state what you have recorded here?

A. I first made a transcript of all of the bank deposit slips in the records of the various banks, and from that transcript and the cash receipt records of Gene Clark, Incorporated, I endeavored to match corresponding entries. After those items had been matched, the unidentified items of cash re-

(Testimony of Donald E. Phillips.)

ceipts and the unidentified items on the bank deposit slips were then put onto this schedule. Then further matching was done within this schedule, and all items of currency or checks issued by Gene Clark, Incorporated were assumed to be currency and unidentifiable.

Q. Well, then, if I understand you correctly, your process was to match the bank deposits, the specific items of bank deposits against specific sales records, and where, for example, a check had been deposited in, we will say, the amount of \$69.03, and you found no sale in that precise amount, you took that as an unreported sale; is that correct? [227]

A. Yes, sir.

Q. Without further investigation?

A. Yes, sir.

Q. Now, isn't it true that in that investigation that you found a large number of sales for which you found no corresponding cash?

A. Yes, sir, that is true.

Q. How did you treat those transactions?

A. On any sale that was not identified by amount, or was summarized, I used the amount of that sale or cash receipt as a reduction from the schedule in which I had added these unreported or so-called unreported items.

Q. Well, let's assume, for example, that on a given day there were receipts for \$500 in sales. There were \$500 worth of checks deposited in the bank, but the constituent checks were in amounts which did not correspond with the exact sales. How

(Testimony of Donald E. Phillips.)

did you treat those items? Did you treat them both as unreported sales, both groups?

A. No, sir, I would not. I would have used the unidentified items in the bank deposits as an addition to my schedule, but the unidentified sales would have been used as a reduction of the same schedule.

Q. You would take the identified sales, as set forth on the receipt book, is that correct, and would you then credit those against the sales reported?

A. I don't understand the question.

Q. All right. For example—and this occurred very often, did it not—you would find \$500 worth of sales, and you would also find a \$500 deposit, but the items making up the deposit were largely in checks and in amounts which did not correspond to the receipts, is that correct, to the individual receipts?

A. Yes, that's correct.

Q. Now, how would you treat those two groups of items, that is, the checks as compared to the receipted sales?

A. If there was detail of the sales, listing specific amounts, and there was no corresponding bank deposit item to any one of the individual sales, I would then add the bank deposit item to income.

Q. And what would you do with the sale for which you found no corresponding bank deposit, specific sale?

A. I would do nothing.

Q. Well, how were those sales treated then in your report?

A. They were unchanged.

(Testimony of Donald E. Phillips.)

Q. Well, now, you took those as the reported sales of the corporation, is that correct?

A. Yes, sir, whenever there were detailed amounts of the sales, they were allowed.

Q. Isn't it a fact that from the sales records, now, exclusive of the bank deposits, the record of sales of the corporation equalled the amount of sales reported; is that [229] correct?

A. Yes, sir.

Q. And you say also the bank deposits equalled the amount of sales reported on the return?

A. Yes, sir.

Q. But that you added to sales all of the bank deposits, however, which did not correspond in exact amount with an individual sale on the particular day; is that correct? A. Yes, sir.

Q. And on the basis of that, you increased the amounts of the corporation income in those amounts as set forth in your report, which is here in evidence? A. Yes, sir.

Q. And on the basis of that, you distributed, after making some allowance for accrued Federal income taxes, the balance in your report to the individual stockholders on the basis of their stock ownership; is that correct? A. Yes, sir.

Q. And without relation to any evidence of what either of them actually received?

A. I made an attempt at a determination for what they had actually received, and I could not identify the amounts, and therefore used the stock ownership.

(Testimony of Donald E. Phillips.)

Q. Well, now, as a matter of fact, and aside from the schedules to which I have called your attention and which are [230] here in evidence as Petitioners' 9, 10, 11, and 12, and with the further exception of those items which are set forth on the schedule of payments, the source of payments made to Fred Keenan of Keenan Pipe & Supply Company, did you find any specific items of cash going to the petitioners Archie or Fawn Koyl?

A. I have not had an opportunity to determine from those schedules whether they are correct or incorrect.

Q. Well, they are very brief. With reference to the year 1946, there were three items representing corporation checks used for materials or services on Mr. Koyl's home. Did you find any items going to Mr. Koyl directly or indirectly, specific items, in the year 1946, other than those three?

Mr. Machtinger: If your Honor please, I object to that question. The witness has testified to the manner in which he prepared his work papers and allocated the income of the corporation. He has also testified that he attempted to discover what specifically went to the individual stockholders, and could not. I think counsel is merely repeating his questions now.

The Court: I don't think so, Mr. Machtinger. The witness hasn't indicated that he couldn't find anything. He asserts that he couldn't find anything which he considered adequate for the purpose. But here he is shown certain specific items and he is

(Testimony of Donald E. Phillips.)

asked if he found any others. I think he must answer that question; either did or he didn't. He has a record of them or doesn't have a record of them.

A. The petitioner Fawn Koyl received \$200 on February 1, 1947, which she placed in an account called "Trustee for Rodney S. Koyl."

Q. Where did she receive that money?

A. I don't know, sir.

Q. And from whom did she receive it?

A. I don't know. She placed it upon the bank——

Q. The fact that the——

Mr. Machtinger: Will you let the witness answer the question that you asked? I didn't understand that he had finished itemizing what the petitioners had received.

Do you have any more that you want to point out?

The Witness: That's right.

Mr. Machtinger: I think he should be entitled to answer the full question before you interrogate him any further.

Mr. Campbell: I have asked him concerning 1946. He has referred to a 1947 item.

Mr. Machtinger: I didn't understand your question referring to a specific year. I am sorry.

Q. (By Mr. Campbell): All right. What specific items did you find were received from the corporation by either Archie or Fawn Koyl in 1946, in addition to these three items?

(Testimony of Donald E. Phillips.)

A. I have no identification of anything coming from the corporation. [232]

Q. Other than these three items?

A. Other than the fact that there were travel expense checks and similar checks issued.

Q. Well——

A. But I do not know as to the receipt of said checks.

Q. As to travel checks received by Mr. Koyl, did you find that any of those checks were deposited by him in his account? A. Not in 1946.

Q. All right. Did you have anything of any individual items received by the Koyls from the corporation in 1946? A. No.

Q. You do not? A. No, sir.

Q. Directing your attention to the year 1947, as Petitioners' 10, there is set forth there certain items as having been received from the corporation by Mr. Koyl in addition to those reported on his return. Do you have any items of any specific items which either he or Fawn Koyl received from the corporation, in addition to the items set forth there? A. No, sir, I do not.

Q. I call your attention to Exhibit 11, with reference to the year 1948, wherein there are set forth certain items as having been received, and deposited in the account of Koyl, of sales of the corporation. Did you find any additional, specific items that Mr. Koyl or his wife received from the corporation in [233] 1948, other than those reported in their returns and as set forth on this schedule?

(Testimony of Donald E. Phillips.)

A. No, sir.

Q. I call your attention to Exhibit 12 with relation to the year 1949, in which there is set forth an item of credit of the corporation's check, and ask you if you found in your examination any specific items which Mr. Koyl or his wife received in 1949 from the corporation, other than as set forth in his return for that year, or upon this schedule?

A. If you mean "from the corporation" by one of its checks—no, sir.

Q. No, I didn't ask "by one of its checks." At any time, I said, from the corporation.

A. Do I understand you to mean from unreported income, sir?

Q. I asked from the corporation.

A. Only the unidentifiable bank deposits.

Q. Well——

A. To their various accounts.

Q. But you have no specific items, is that correct? A. No, sir.

Q. Now, you have referred to the bank account of Mr. Koyl and what you have termed unidentified deposits therein. And, as a matter of fact, you then carried into your report of the corporation those items which you termed unidentified bank deposits in Mr. Koyl's individual account as being additional income to the corporation, did you not?

A. Yes, sir.

Q. And did you do so only on the basis that you did not, in the course of your investigation, find

(Testimony of Donald E. Phillips.)

what the source of those particular deposits were, is that right?

A. No, sir. During the course of my investigation, I interrogated Mr. Koyl about the East Side Plumbing Company and the Koyl Plumbing Company, for which he received credit upon his re-entry into the corporation for large plumbing inventory, but was never given any records to substantiate such an operation.

Q. Well, you ascertained——

The Court: Let him finish.

Mr. Campbell: I am sorry.

A. (Continuing): And therefore the unidentified bank deposits in many cases appeared to me to have been from some type of individual plumbing company operation.

Q. (By Mr. Campbell): But you charged those to the corporation, did you not?

A. No, sir, not while he was outside the corporation.

Q. And that, then, refers only to the year 1948?

A. Yes, sir.

Q. But as to the other years, 1947, 1949, and 1950, did you charge the unidentified, what you term unidentified deposits in his personal accounts as income of the corporation?

A. Yes, sir, I did. [235]

Q. And then, as I understand you, in 1948 you charged it as income, these deposits as income to Mr. Koyl on the theory or the basis that he was conducting a private business?

(Testimony of Donald E. Phillips.)

A. Yes, sir, he had so informed me.

Q. And did you in that connection make any allowance for costs of doing business?

A. I asked him for such records and received none.

Q. As a matter of fact, he told you, did he not, that he was not in the plumbing business, but was acquiring materials in contemplation of entering the plumbing business?

Mr. Machtinger: Objection. What he told the witness is hearsay.

The Court: No, I don't think so. It doesn't have to be true, but the witness has testified that Mr. Koyl admitted to him he was in the business. Now, counsel is asking him on cross examination whether he didn't say something else. The witness can answer whether Mr. Koyl told him that or not.

A. He and his representatives have both stated to me that they bought for cash at auctions. They traded materials for other strategic materials, and yet never produced a record to substantiate it.

Q. (By Mr. Campbell): That is as to the acquisition of materials. What were you told with reference to the conduct of the business?

A. Only that he had started one. [236]

Q. Only that he was acquiring materials?

A. He just said that he had started a company.

Q. All right. Were you informed that the company was operated, that is, by the sale of material or by the sale of services, or did you presume that?

A. I presumed that.

(Testimony of Donald E. Phillips.)

Q. Yes. All right. Now, coming to these bank accounts, did you make any effort, during the course of your investigation, to determine the source of all of the funds which went into his bank account?

A. Yes, sir, I did.

Q. You knew, as a matter of fact, did you not, that during the years '48, '49, and '50, or that portion of '50 which is involved in the corporation return, that Mr. Koyl had a number of rental properties?

A. Yes, sir, I did.

Q. And that he was receiving substantial amounts of rent from those properties, is that right?

A. Yes, sir.

Q. And, incidentally, was reporting them on his returns, isn't that correct?

A. He was reporting rental incomes.

Q. Now, isn't it a fact that during the year 1947—pardon me—during the fiscal year of the corporation ending 1947, that Mr. Koyl deposited a total in his accounts of [237] \$2,694.60?

A. I do not know that, sir.

Q. Will you examine your records? You state you had made an analysis of his bank accounts?

A. I made them on a calendar-year basis.

Q. Well, as to 1947, '49, and '50, fiscal years of the corporation, you were adding those deposits, unidentified deposits to the corporation income, were you not?

A. Yes, sir, I was.

Q. Do you have a breakdown of that?

A. I have the bank deposit records here, but I

(Testimony of Donald E. Phillips.)

A. Yes, sir, he had so informed me.

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Q. Well, as to 1947, '49, and '50, fiscal years of the corporation, you were adding those deposits, unidentified deposits to the corporation income, were you not? A. Yes, sir, I was.

Q. Do you have a breakdown of that?

A. I have the bank deposit records here, but I

(Testimony of Donald E. Phillips.)

do not have them summarized in the same way you do, sir.

Q. Well, I am going to show you a summary which I have in my hand, which purports to show on the fiscal year basis an analysis of receipts and cash coming into the possession of Mr. Koyl, the total amount of bank deposits for the same periods, and ask you if this corresponds, or the figures set forth hereon, correspond with those developed by you in the course of your examination? [238]

* * * * *

A. I do not know specific items could be picked out by me. But in trying to reconcile anything that I have on a calendar-year basis for a fiscal-year computation such as you have, I would have to check each individual item.

Q. Yes. All right. Now, in the fiscal year 1947, ending April 30, 1947, what amount of the Koyls' bank accounts did you charge as additional income to the corporation?

A. \$500 from the Fawn Koyl "Trustee for Rodney S. Koyl" No. 21268 in the Citizens National Maywood Bank—Maywood Branch, rather.

Q. And on what basis did you charge that to the corporation?

A. On the basis that it had not been identified for me in compliance with my many requests.

Q. Did you request Mrs. Koyl to identify that for you? A. No, I did not.

Q. All right. Now, is that the total amount that you—— A. No, sir.

(Testimony of Donald E. Phillips.)

Q. All right. What else?

A. \$159 of deposits in the Fawn Koyl "Trustee for David T. Koyl," term account No. 15713.

Q. What was the source of that money?

A. I do not know, sir.

Q. Did you charge that to the corporation?

A. Yes, sir, I did. [242]

Q. What else?

A. And \$830 deposits to the account of Archie Koyl, Citizens National Bank, Maywood Branch.

Q. What was the source of those funds?

A. I do not know, sir.

Q. All right. That covers the total?

A. Yes.

Q. What is the total amount in 1947?

A. Was that 1946 only you were asking for, sir?

Q. Yes.

A. \$140 against the Fawn Koyl "Trustee for David T. Koyl" No. 15713, was a 1947 item.

Q. What was the source of those funds?

A. I do not know, sir.

Q. The account referred to is a trustee account for one of the minor children of the parties, is that right?

A. Yes, sir, it was.

Q. Did you charge that to the corporation?

A. Yes, sir.

Q. All right.

A. Also, in that same account, a \$400 deposit, that is account No. 15713, in October of 1947.

Q. What was the source of that fund?

A. I do not know, sir.

(Testimony of Donald E. Phillips.)

Q. That was to the children's account? [243]

A. Yes, sir.

Q. All right.

A. And to another term account No. 21268, May 23, 1947, and October 1, 1947, a total of \$800.

Q. Is your testimony the same, no knowledge as to the source of those funds?

A. That's right, sir.

Q. Would your testimony be the same as to all of the bank account items that you have charged as corporation income, as arising from unidentified deposits in the bank accounts of Archie or Fawn Koyl, either for themselves or for their children?

A. Is this for all years?

Q. For all years.

A. With the exception of the September 1947 deposit to the Archie Koyl account, Citizens National Bank, Maywood Branch, of \$1,805.50, on October 1, 1947 of \$1,840.

Q. Aren't those the same Ben Lang checks concerning which we have previously had testimony?

A. Yes, sir, they are.

Q. All right.

A. Also, a J. W. Dyer, Incorporated check of December 22, 1947 of \$509.84.

Q. Do you know, aside from knowing the name of the maker of that check, do you know for what purpose it was paid? Did your investigation disclose that? [244]

A. It did, sir, but I would have to go back into this, if you will pardon me.

(Testimony of Donald E. Phillips.)

Q. This being one of the few exceptions, will you do so?

A. To the best of my memory, that was unreported income to the corporation.

Q. But it belonged to the corporation?

A. To the best of my recollection, sir, yes.

Q. What was it for?

A. I do not remember, sir.

Q. As a matter of fact, don't you remember, Mr. Phillips, as to that specific item, that that was a reimbursement for Mr. Dyer, a resident of San Diego, to Mr. Koyl for an accommodation purchase which the Koyls had made for him? Do you recall that?

A. I did not personally ever talk to Mr. Dyer.

Q. That fact was explained to you at the time, was it not? Were you advised? A. By whom?

Q. By Mr. Koyl. Do you recall that?

A. No, I do not, sir.

Q. All right. Aside from those items that you have directed attention to, is your testimony the same as to the balance of the bank accounts charged as corporation income?

A. No, sir, I still have some more items.

Q. All right.

A. We have an Archie Koyl account in the Bell Gardens [245] bank, Bell Gardens; up to the time that I had written my report, Mr. Koyl had never informed me that he had such a bank account, although on many occasions I had asked him for a full list of bank accounts.

(Testimony of Donald E. Phillips.)

Mr. Campbell: I ask that that last be stricken as not responsive to the question.

Mr' Machtinger: I object to having that stricken, your Honor. It is responsive to the question of where——

The Court: No, I do not think so. But if you ask him the same question on redirect, I will overrule any objection to it.

Mr. Campbell: I withdraw the motion then.

The Court: It is in the record, then.

A. A deposit in 1947 of \$826, Harry McCabe.

Q. (By Mr. Campbell): That is the same item which is set forth on Petitioners' Exhibit 10, is it not, of \$826? A. Yes, sir, it is.

Q. All right. Now, what else?

A. 1948, item of \$600, Frodsham, Monty.

Q. That is the same item as set forth on Petitioners' Exhibit 11, is it not?

A. Yes, sir, it is. A Ben Lang item of \$1,055.50.

Q. That is also set forth on Petitioners' Exhibit 11, is it not? [246]

A. Yes, sir, it is. And an \$850 item, Monty Frodsham.

Q. That is also set forth on Petitioners' Exhibit 11, is it not? A. Yes, sir, it is.

Q. What else do you have?

A. In the fiscal year ended April 30, 1950, on page 79 of my report, to the Archie Koyl account, Citizens National Bank, Maywood Branch, item——

Q. What is the date?

(Testimony of Donald E. Phillips.)

A. July 19, 1949. Earl Bryan, \$52.50, Earl Bryan, 151.28.

Q. Just a moment, please. That is the same item as set forth on Petitioners' Exhibit 13, is that correct?

A. It is the same amount, sir.

Q. Same date too, is it not?

A. Yes, sir, it is.

Q. And the same maker, is it not?

A. Yes, sir, it is.

Q. All right. Now, what is your next one?

A. Earl Bryan, August 12, 1949, \$213.60.

Q. That is also set forth on Petitioners' Exhibit 13, is it not? A. The amount is, sir.

Q. And the date? A. There is no date there.

Q. Isn't that indicating the date above, 8/12/49?

A. If that mark means a ditto, it is, sir.

Q. The checks under the word "Earl Bryan," doesn't that indicate Earl Bryan?

A. All right.

Q. Is there any doubt in your mind that is the same item? A. No, sir.

Q. All right. Let's got on to the next.

A. Earl Bryan, amount of \$36.55.

Q. On what date?

A. August 12, 1949.

Q. That is also set forth on Petitioners' 13, is it not?

A. Yes, sir, it is. Baker Construction Company check dated—in deposit—dated December 13, 1949, \$619.

(Testimony of Donald E. Phillips.)

Q. That is also on Petitioners' 13, is it not?

A. Yes, sir. All right, Earl Bryan check, in deposit of September 13th, the amount of \$276.77.

Q. That is also on Petitioners' Exhibit 13, is it not?

A. Yes, sir, it is. Earl Bryan check in the deposit of January 5, 1950, the amount of \$500.

Q. That is also on Petitioners' Exhibit 13, is it not?

A. Yes, sir. A Basford N. Edwards check in the deposit of January 9, 1950 of \$158.62.

Q. That is also on Petitioners' 13, is it not?

A. Yes, sir, it is. A Virgil Burmood check, in the January 9, 1950 deposit, of \$222.09. [248]

Q. That is also on Exhibit 13, is it not?

A. Yes, sir, it is. Virgil Burmood check in the deposit of February 3, 1950 of \$247.06.

Q. That is also on Exhibit 13, is it not?

A. Yes, sir, it is. Earl Bryan check of \$200 in the deposit of March 13, 1950.

Q. How much? I thought you said March 13th. March 10th, is it not?

A. It is in the March 13th deposit. These may be the date of the checks.

Q. Yes. You find such an item dated March 10, 1950 on Exhibit 13?

A. Yes. And an amount of \$88.10 from Virgil Burmood in this same deposit of March 13th.

Q. That is also listed here on Exhibit 13?

A. Yes, as of the date of March 11th.

Q. All right. Have we covered all of the identi-

(Testimony of Donald E. Phillips.)

fied items which you have charged the corporation?
A. Yes, sir.

Q. And I take it then as to all other items of bank deposits from Archie and Fawn Koyl bank accounts, or the children's bank accounts, your investigation did not disclose the source of those funds; is that correct?

A. That is right, sir.

Mr. Campbell: I am going to ask that this document [249] which was shown the witness, but of which he could make no comparison, which is entitled, "Analysis of Receipts, Bank Deposits and Cash Fund," be given a number for identification.

The Clerk: Petitioners' Exhibit 21 for identification.

(Petitioners' Exhibit Number 21 was marked for identification.)

Q. (By Mr. Campbell): Mr. Phillips, in connection with your examination of the affairs of Archie and Fawn Koyl, and for the purpose of determining whether or not your proposed finding that they received, constructively or otherwise, the amounts as set forth by you in your report, did you make investigation of the net worth of Archie and Fawn Koyl for the years in question?

A. Not in particular, sir.

Q. You say "not in particular." Did you make up a schedule in general as to their net worth?

A. I never did, sir.

Q. Well, now, wasn't there presented to you a net worth summary relating to Archie and Fawn

(Testimony of Donald E. Phillips.)

Koyl for all years from 1944 to 1950, inclusive?

A. At various times, many so-called net worth or cash-in and cash-out statements were submitted on behalf of the taxpayer to me.

Q. And I presume you made examination of those for the [250] purpose of determining whether or not your findings, which were the basis of the Commissioner's findings, were correct, did you not?

A. Yes, sir, I did.

Q. I am going to show you a two-page document.

Mr. Campbell: I will ask to have this two-page document, which is headed "Archie and Fawn Koyl Net Worth Summary, 1944 to 1950" marked for identification.

The Clerk: Petitioners' Exhibit 22 marked for identification.

(Petitioners' Exhibit Number 22 was marked for identification.)

Q. (By Mr. Campbell): I will ask you if this particular document of the net worth of Archie and Fawn Koyl was presented to you during the course of or prior to your appearance here, the original of which this is a photostatic copy?

A. This is not dated, nor does it have anyone's signature.

Q. That was not my question, sir.

A. I do not know if I have ever seen the original of this document, sir.

Mr. Campbell: Will it be stipulated that the

(Testimony of Donald E. Phillips.)

original of this document or a duplicate of this document was furnished to the Government?

Mr. Machtinger: I don't question that it was, but in [251] all sincerity I don't recall ever having seen it. It may have been presented——

The Court: Mr. Campbell, you are not going to be able to bring that in the picture unless somebody establishes it, anyhow.

Mr. Campbell: Yes, your Honor.

The Court: If it was presented, the person who presented it can testify if he recalls.

Q. (By Mr. Campbell): Do you have any net worth computation that you worked up, Mr. Phillips? A. No, sir, I do not.

Q. Now, what investigation did you make, Mr. Phillips, to determine if the taxpayers actually received the sums of money which you charged them with in your reports?

Mr. Machtinger: I believe the witness has testified to the manner in which he attributed the income to the taxpayers and his investigation with respect to the bank deposits.

Mr. Campbell: I understand that, but I want to see now what investigation he made as to whether they received it.

Mr. Machtinger: I think he also testified that, to the effect that he didn't investigate or set up his schedules on the basis of whether they actually received it, but on the basis that they constructively received these funds.

Mr. Campbell: Well, I understood from him, his

(Testimony of Donald E. Phillips.)

[252] definition, that a constructive dividend was a payment in cash or property of an undeclared dividend.

The Court: What the witness testified to, he didn't know whether they got it or not. He had no way of determining whether they got it or not, and he attributed it on a 70-30 basis, in accordance with stockholdings.

Isn't that correct?

The Witness: That's correct.

Mr. Campbell: May I have just a moment, Your Honor?

Q. (By Mr. Campbell): In connection with your analysis of the corporation and of Mr. Koyl's affairs, did you attempt to ascertain what specific amounts Mr. Clark secured?

Mr. Machtinger: Objection, Your Honor. The specific amounts that Mr. Clark secured have no bearing here, if we are still working on our 70-30 theory.

The Court: Well, I don't know that it would have any bearing except that, conceivably, if Mr. Clark actually received more than 70, it might indicate that this petitioner received less than 30. I don't know where it is going to get to, but I am certainly not going to go into this case as to the details of what Mr. Clark got or didn't get. But I am willing to go far enough for this witness to indicate generally whether he had specific information as to Clark or not. After all, he is an accountant. If he handled it as to one, he might have done [253]

(Testimony of Donald E. Phillips.)

some calculation as to the other. It is up to him to speak. So go ahead and answer the question.

A. In some specific instances, I could trace amounts to Mr. Clark's.

The Court: Do they represent the full 70 percent that you attributed to Mr. Clark, or anything like it?

The Witness: There is no percentage determination from the actual amounts traceable, Your Honor.

The Court: I understand. But do they have any relationship in total amounts to 70 percent, those that you traced specifically into Mr. Clark's account?

The Witness: No, sir.

The Court: Broadly speaking, did you have any better basis for attributing to Mr. Clark than you did to attribute to Mr. Koyl?

The Witness: No, sir, I did not.

The Court: All right. [254]

* * * * *

Mr. Campbell: It will be stipulated with respect to Exhibit 19, which has heretofore been admitted for a limited purpose, that the figures thereon represent the income of the corporation as corrected; that the references thereon are to the revenue agent's report showing the amounts which have been added to or subtracted from income with reference to the findings of the revenue agent, and which were the basis of the 90-Day Letter in the corporation case.

(Testimony of Donald E. Phillips.)

It will be stipulated that the figures of corrected income as set forth hereon are the true and correct income of the corporation for the years in question.

Mr. Machtinger: I think we should make it clear to the Court that it is these figures which were used as the basis for arriving at the stipulated deficiency in the corporation case.

The Court: I understand. And now, for the purpose of this case, you agree they are correct?

Mr. Machtinger: Yes, sir.

The Court: All right.

Mr. Campbell: That is all.

Redirect Examination

Q. (By Mr. Machtinger): You testified in cross examination that constructive dividends mean money taken by the person to whom those dividends are charged. Is the meaning of constructive dividends necessarily limited to money actually taken?

Mr. Campbell: Objected to as calling for his legal conclusion.

The Court: I don't think it is necessary to go into that. Constructive dividends usually do have a special connotation somewhat different than the term as used by this witness. But he has explained clearly enough what he meant by it.

Mr. Machtinger: If the Court please, the witness has testified from work papers, setting forth the cash receipts unidentified as compared to the deposit items unidentified. I would like to offer these work papers in evidence as Respondent's next in order.

(Testimony of Donald E. Phillips.)

Mr. Campbell: I have no objection.

The Court: Very well. They will be received.

The Clerk: Respondent's Exhibits J, K, L and M admitted in evidence.

(Respondent's Exhibits J, K, L and M were marked for identification and received in evidence.)

Q. (By Mr. Machtinger): You testified that you prepared these work papers, identified as Respondent's Exhibits J, K, L and M from other work papers. From what work papers or schedules did you prepare [256] these schedules?

A. From work papers containing a transcript of the bank deposit items of all of the bank deposits made by the Gene Clark, Incorporated.

Q. Does that schedule contain all of the bank deposits and the items listed on those bank deposits for all four years involved here?

A. Yes, they do.

Mr. Machtinger: Will counsel stipulate that the schedule set forth here corresponds to the items set forth on the bank deposits as deposited by the corporation for the four years involved?

Mr. Campbell: I have no way of determining——

Mr. Machtinger: We could subpoena——

The Court: Mr. Campbell, it certainly would be a little bit ridiculous to bring the bank's records here. Can't you——

Mr. Campbell: I agree to that.

The Court: ——stipulate them subject to check?

Mr. Campbell: I was about to make——

(Testimony of Donald E. Phillips.)

The Court: We can give you an opportunity to check them. If you find anything wrong with them, then I will reopen, if necessary, for that purpose.

Mr. Campbell: I was about to make that suggestion, Your Honor. [257]

The Court: All right.

Mr. Machtinger: Thank you, sir.

Mr. Campbell: Those are the corporation?

Mr. Machtinger: Those are the corporation.

Mr. Campbell: May I make this suggestion, then: I think we have available the original transcripts, if you are agreeable that they be substituted for those.

Mr. Machtinger: I have no objection to substituting the original transcripts.

Mr. Campbell: All right.

The Court: Let's get them and substitute them. It doesn't have to be done at the moment. It is understood they will be substituted, and of course they will be subject to your check, Mr. Machtinger.

Q. (By Mr. Machtinger): Mr. Phillips, did you compare the items set forth on the bank deposit slips of the corporation to the cash receipts journal of the corporation? A. Yes, sir, I did.

Q. What does your schedule show, if anything, with respect to such comparison?

A. Wherever an amount was the same that was in the bank deposit, as the cash receipt, I placed the number of the cash receipt to the right of the items or the ABA number appearing for that item, in this transcript. [258]

(Testimony of Donald E. Phillips.)

Q. Did you find that all items listed in the cash receipts journal were correspondingly listed as some item on the cash deposit slip? A. No, sir.

Q. Did you prepare a schedule setting forth those items which you discovered in the cash receipts journal which were not included as a specific item in the cash deposit slip?

A. Yes, sir, I did.

Q. Do you have such schedule?

A. They are incorporated in those schedules that you just put in.

Q. Referring to the schedules identified as Respondent's Exhibits J, K, L and M, can you explain to the Court, through an example, of an item that was listed in the cash receipts journal but for which there was no corresponding item listed in the bank deposit slips, and what you did on your work sheets when you discovered such a fact?

Mr. Campbell: Is he looking for some specific one? He has turned over some nine sheets up to this time.

Mr. Machtinger: I asked the witness to give an example to the Court of how he would handle such an item. I imagine he is looking for one which would be simple to explain.

A. On the unidentified deposit items listed in the deposit dated June 14, 1947, in the total amount of \$14,260.30, the unidentified cash receipt of \$1,900 for Charles Hasekian [259] could not be matched to the—that particular day's deposit, and there is a note, "Cash receipt, 4,620," that \$1,900 was not

(Testimony of Donald E. Phillips.)

deposited. On the deposit dated June 20, 1947 in the total amount of \$11,813.24, an unidentified item of deposit of \$2,445, a check from Hamilton Homes, No. 1385, dated June 13, 1947, was deposited. No cash receipt in the amount of \$2,445 for the account of Hamilton Homes was found in the set of books of Gene Clark, Incorporated during this period.

Q. (By Mr. Machtinger): Can you identify the specific page to which you are now referring?

A. It is page 2 of 9 of Exhibit M.

Q. Did you discover whether or not the corporation ever cashed checks for its employees, let's say salary checks of employees?

A. Many checks issued by Gene Clark, Incorporated were included in their deposits.

Q. Such a deposit would not be correspondingly included in the sales journal, would it?

A. No, sir, it would not.

Q. Did you add the total amount of such checks to the corporate income? A. No, sir, I did not.

Q. Did you attempt to trace the source of these checks for which there was no corresponding entry in the cash receipts [260] journal, or no corresponding entry in the sales journal?

A. Yes, and some of them were identified.

Q. Did you ask the representatives of the petitioners as to an explanation of the source of these unidentified checks? A. Yes.

Q. Did you ask the representatives of the corporation as to the source of these unidentified checks? A. Yes.

(Testimony of Donald E. Phillips.)

The Court: Did they answer your inquiries or not?

The Witness: Specifically, Fred Files, who is office manager, said that it was a regular practice to substitute checks, and that Gene Clark carried many checks of customers in his pockets, and would bring them in and substitute them for cash.

Q. (By Mr. Machtinger): Did you ask those questions of Gene Clark or Archie Koyl?

A. I never talked to Gene Clark during the course of this investigation.

Q. Did you talk to Mr. Koyl?

A. Yes, sir, I did.

Q. Did you ask him as to the source of these unidentified checks?

A. Yes, sir, I did.

Q. Did he answer you? [261]

A. Not as to identifying any of the specific items.

Mr. Campbell: I ask that that be stricken as not responsive.

Q. (By Mr. Machtinger): Did he answer you?

The Court: What did he answer?

Mr. Campbell: That's a negative——

The Witness: He answered that it was common practice for Gene to take currency and to replace them with checks, and that as far as he could remember that he hadn't done it.

Q. (By Mr. Machtinger): Was it possible for you in the course of your examination of the books

(Testimony of Donald E. Phillips.)

and records of the corporation to determine who got these unidentified proceeds?

A. No, sir, it was not possible.

Q. Referring you to Petitioners' Exhibit 13, Mr. Phillips, did you in the course of your investigation discover whether or not the payments made by the individuals listed on this exhibit were amounts which were owing by these individuals to the corporation?

Mr. Campbell: I will stipulate, Mr. Machtinger, that they were. I have those people's files here, if there is any question, but I will stipulate.

Mr. Machtinger: So stipulated. [262]

Q. (By Mr. Machtinger): Did the corporation include these amounts as income?

Mr. Campbell: I will stipulate that the corporation—go ahead. Let him answer it.

A. No, they did not.

Q. (By Mr. Machtinger): Referring you to the two Ben Lang checks identified as Respondent's Exhibits B and C, it has been testified to by Mr. Koyl that these payments of \$1,805.50 and \$1,840 were made in consideration of debts due the corporation. Does your investigation disclose whether or not the corporation included these amounts as income?

Mr. Campbell: Just a moment. I think by way of our settlement we have agreed that they were not income to the corporation—I mean by way of our stipulation.

(Testimony of Donald E. Phillips.)

Mr. Machtinger: Well, our stipulation gives the total figure.

Mr. Campbell: I beg your pardon. I was thinking of another item. They were income to the corporation.

Mr. Machtinger: Will you stipulate that they were income to the corporation?

Q. (By Mr. Machtinger): Did the corporation include it on its records as income?

Mr. Campbell: I think that is covered by the stipulation. I think they did not. [263]

Q. (By Mr. Machtinger): Do your records show whether there were any items, any checks substituted in the corporate bank deposit to account for the \$1,805.50 and \$1,840 which were not deposited to the corporation bank account?

A. These were not substituted items. They were not deposited to the bank account of the corporation.

Mr. Campbell: While counsel is doing that, may I see that Hasekian item? I want to get the date of it, if your Honor please.

Q. (By Mr. Machtinger): In the course of your investigation, Mr. Phillips, did you discover whether or not there had been travel and expense checks made out by the corporation in favor of Mr. Koyl? A. Yes, sir.

Q. Would not the proceeds of such checks be received by Mr. Koyl whether or not the checks were deposited in his account, if he so cashed the checks?

(Testimony of Donald E. Phillips.)

Mr. Campbell: If he knows.

Q. (By Mr. Machtinger): If you know.

A. I don't know what would happen to the proceeds of those checks.

Q. But if he cashed the checks, then the amounts would not necessarily be deposited as a check item in his own bank [264] accounts, would they?

Mr. Campbell: Objected to as argumentative.

The Court: Well, the question answers itself. If he cashed them, he didn't deposit them. If he deposited them, he didn't cash them.

Q. (By Mr. Machtinger): With respect to the items deposited in the bank accounts of Mr. or Mrs. Koyl, whom did you ask as to the source of the funds which were deposited in such bank accounts?

Mr. Campbell: I think that has been covered by the stipulation. Those were eliminated from corporate income, I think, Mr. Machtinger.

Mr. Machtinger: I think it might be pertinent in that, although we have agreed as to the amount of corporate income, there has not been any agreement as to the amount of such income which went to Mr. Koyl. There was testimony on cross by Mr. Phillips that he did not ask Mrs.——

Mr. Campbell: For that purpose I withdraw the objection.

A. The only ones I ever asked were Mr. Koyl or representatives of the company, such as Benny Kay or Fred Files.

Q. (By Mr. Machtinger): Did you ask Mr.

(Testimony of Donald E. Phillips.)

Koyl as to the source of the funds deposited in Mrs. Koyl's bank account?

A. Yes, sir, I did. [265]

Q. Did he give you an answer?

A. Only by submission of a cash-in and cash-out statement.

Q. Was it your understanding that Mr. Koyl was endeavoring to answer on behalf of Mrs. Koyl as to the source of those funds?

A. Yes, sir, it was.

Q. Did Mr. Koyl ever refer you to Mrs. Koyl for those answers?

Mr. Campbell: Objected to as immaterial.

Mr. Machtinger: In view of the question on cross as to whether or not he had never interviewed Mrs. Koyl, I think that question is pertinent.

The Court: Well, Mr. Machtinger, does it make any difference? These were community-property returns. It has been conceded right straight through that they represented half of the income, that Mr. Koyl was the one who produced it, and no one has raised any question about his right to speak for his wife under those circumstances.

Mr. Machtinger: No more questions. [266]

* * * * *

[Endorsed]: Filed April 18, 1955.

[Endorsed]: No. 16010. United States Court of Appeals for the Ninth Circuit. Gene O. Clark and Faye Clark, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed: May 7, 1958.

Docketed: May 9, 1958.

Supplemental Filed: June 4, 1958.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for
the Ninth Circuit.

United States Court of Appeals
For The Ninth Circuit

No. 16010

GENE O. CLARK, FAYE CLARK,

Petitioners on Review,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

STATEMENT OF POINTS

Petitioners on Review intend to rely upon the following points:

That the Tax Court of the United States erred:

I.

In holding and finding that Petitioners on Re-

view did not sustain their burden of proof for each of the years 1946 and 1947.

II.

In holding and finding that the determination of Respondent on Review was not arbitrary, capricious, erroneous, and invalid.

III.

The findings of fact of the Tax Court are not supported by the evidence.

IV.

In holding and finding that Gene Clark, Inc., a California corporation, received substantial amounts of taxable income from unreported sales, which it failed to report on its returns for the fiscal years ending April 30, 1947 and 1948.

V.

In its determination of the amounts of alleged unreported income of Gene Clark, Inc., for its fiscal years ending April 30, 1947 and 1948.

VI.

In its allocation of alleged unreported income of Gene Clark, Inc. for its fiscal years ending April 30, 1947 and 1948, to Petitioners on Review for their calendar years 1946 and 1947.

VII.

In holding and finding that alleged corporation income which Respondent on Review asserted and

determined was not available for distribution by Gene Clark, Inc., for its fiscal years ending April 30, 1947 and 1948, was available for distribution and was distributed to Petitioners on Review for the calendar years 1946 and 1947.

VIII.

In its failure to accrue and deduct State of California franchise taxes and fraud penalties from the amount alleged to be available for distribution from Gene Clark, Inc., for its fiscal years ending April 30, 1947 and 1948.

IX.

In its failure to deduct State and Federal fraud penalties of Gene Clark, Inc., for its fiscal year 1947 and State and Federal franchise and income taxes, respectively, for its fiscal year 1948 from the amount the Court determined on a theoretical basis was distributed to Petitioners on Review, out of the alleged unreported income of Gene Clark, Inc., for its fiscal year 1948.

X.

In holding and finding that Petitioners on Review withheld and diverted to their own purposes, substantial amounts of the proceeds of alleged unreported sales, and that they realized informal or constructive dividends from Gene Clark, Inc., for the calendar years 1946 and 1947.

XI.

In its determination of the amounts of alleged

diverted proceeds from alleged unreported sales and the amounts of the alleged unreported income from informal or constructive dividends from Gene Clark, Inc., for the calendar years 1946 and 1947.

XII.

In holding and finding that Gene Clark, Inc., did not make certain loans to Petitioners on Review and that the amounts so received by Petitioners on Review were constructive dividends to them.

XIII.

In holding and finding that the assessment and collection as to Petitioner on Review Gene O. Clark was not barred by the Statute of Limitations as to the years 1946 and 1947, and that the assessment and collection as to Petitioner Faye Clark was not barred by the Statute of Limitations as to the year 1947.

XIV.

In holding and finding that Respondent on Review sustained his burden of proof to show an omission of income of more than 25% from Petitioner on Review Gene O. Clark's income tax return for the calendar year 1946 and for both Petitioners on Review for the calendar year 1947.

XV.

In holding and finding that Petitioner Gene O. Clark filed false and fraudulent income tax returns for the years 1946 and 1947, and that a part of

his deficiency for each of said years was due to fraud with intent to evade taxes.

Dated: June 10, 1958.

Respectfully submitted,

BAIRD & HOLLEY,
/s/ By THOMAS A. BAIRD,
Attorneys for Petitioners on
Review.

Certificate of Service Attached.

[Endorsed]: Filed June 11, 1958. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

STIPULATION RE PRINTING OF EXHIBITS

It is hereby stipulated by and between counsel for the respective parties that none of the exhibits introduced into evidence in the above-entitled cases, including the exhibits introduced in connection with the testimony of Revenue Agent Donald E. Phillips, in the related but not consolidated cases of Archie M. Koyl, et al. v. Commissioner (T.C. Docket Nos. 48,336, 48,337 and 48,338), transcript of testimony taken March 29 and 30, 1955, (pp. 156-269), shall be printed, but that all of such exhibits, which are a part of the record of this Court, shall be treated as physical exhibits so that either party

to the appeal may refer to, quote from, or include in his, or her, or its brief, or on oral argument, any part or all of the said exhibits in the same manner as if the said exhibits were printed in the record in their entirety.

Dated: June 27, 1958.

/s/ CHARLES K. RICE,
Counsel for Respondent on
Review.

BAIRD & HOLLEY,
/s/ THOMAS A. BAIRD,
Counsel for Petitioners on
Review.

[Endorsed]: Filed July 10, 1958. Paul P.
O'Brien, Clerk.

TOPICAL INDEX

	PAGE
Opinion below	1
Jurisdiction	1
Statutes and regulations involved.....	2
Statement of the case and questions presented.....	2
Specification of errors.....	4
Summary of argument.....	6

I.

The deficiency notices of the Commissioner are arbitrary, capricious and erroneous on their face. The determinations contained therein cannot be used as evidence against petitioners	8
Substituted deposits	10
Applicable law	13

II.

The Tax Court, without any substantiating evidence and without affirmative pleadings on the respondent's part, added more income than was asserted in respondent's deficiency notices, to petitioners' income for the calendar years 1946 and 1947....	17
--	----

III.

The Tax Court failed to properly accrue and deduct taxes, penalties and interest in determining earnings and profits available for distribution.....	21
--	----

IV.

Based upon the record in this case the maximum amount of income arising from "constructive dividends" of Gene Clark, Inc., to petitioner Gene Clark would be only \$4,706.78 for the calendar year 1946, and \$953.66 for the calendar year 1947. The maximum amount of such income to petitioner Faye Clark would be \$953.66 for the calendar year 1947.....	23
1946	23
1947	25

V.

The record does not support the court's finding that a loan of the corporation to its officers was in substance a dividend..... 27

VI.

The respondent did not sustain his burden of proof to prove fraud 28

VII.

The respondent has not sustained his burden of proof in regard to affirmative allegations in his answer. Hence the statute of limitations precludes any deficiency to petitioners..... 31

Conclusion 33

iii.

TABLE OF AUTHORITIES CITED

CASES	PAGE
Alcorn Refining Co., 2 B. T. A. 253.....	13
Al Goodman, Inc., 23 T. C. No. 39.....	27
American Enka Corporation v. Commissioner, 30 T. C. No. 65	22
Belridge Oil v. Commissioner, 85 F. 2d 762.....	14
Bruce & Human Drug Co., 1 B. T. A. 342.....	13
Bryant Heater v. Commissioner, 248 F. 2d 939.....	15
Campbell, Vincent C., et al. v. Commissioner, 11 T. C. 510.....	19
Cedar Valley Distillery, Inc., 16 T. C. 870.....	20
Cohan v. Commissioner, 39 F. 2d 540.....	12
Commissioner v. Pacific Affiliate, 224 F. 2d 578, aff'g 18 T. C. 1175, cert. den. 350 U. S. 967.....	22
Crispin, M. Jackson, 32 B. T. A. 151.....	27
Drybrough, F. W., v. Commissioner, 238 F. 2d 735.....	22
Durkee v. Commissioner, 162 F. 2d 184.....	15
Estate of Belyea v. Commissioner, 206 F. 2d 266.....	15
Estate of Stein v. Commissioner, 25 T. C. 940.....	22
Federal National Bank of Shawnee, Oklahoma v. Commissioner, 180 F. 2d 494.....	15
Gasper v. Commissioner, 225 F. 2d 287.....	15
Gray, Bonnie Gladys, et al., P-H Memo. T. C., par. 53,000.....	12
Griffiths v. Commissioner, 50 F. 2d 782, 10 A. F. T. R. 106....	28
Harbor Plywood Corp. v. Commissioner, 143 F. 2d 780.....	20
Helvering v. Taylor, 293 U. S. 507.....	14, 15, 20
Hemphill Schools v. Commissioner, 137 F. 2d 961.....	15, 16
Index Norton Co., 3 B. T. A. 90.....	13
Industrial Trust Co. v. Commissioner, 165 F. 2d 142, 1 A. L. R. 2d 144.....	15
L. Schepp Company, 25 B. T. A. 419.....	28
Leiser, Elsy, P-H Memo. T. C., par. 52,276.....	28, 29

Lenox Clothes Ships, Inc. v. Commissioner, 139 F. 2d 56.....	20
Mauch, Russell C., v. Commissioner, 35 B. T. A. 617, aff'd 113 F. 2d 555.....	30
Meraux, L. A., v. Commissioner, 38 B. T. A. 200.....	30
Perry, J. M., v. Commissioner, 120 F. 2d 123.....	15, 16
Rickard, George L., v. Commissioner, 15 B. T. A. 316.....	30
Roerich, Nicholas, 38 B. T. A. 567, aff'd 115 F. 2d 39.....	29
Royal Highlands v. Commissioner, 138 F. 2d 240.....	14
Russell v. Commissioner, 45 F. 2d 100.....	14
Schlemmer & Garber Co., 2 B. T. A. 823.....	13
Schultze, J. William, v. Commissioner, 18 B. T. A. 444.....	29
Seltzer, Lois, 21 T. C. 398.....	32
Shaken, Victor, 21 T. C. 785.....	27
Sharpsville Boiler Works Co., 3 B. T. A. 568.....	29
Showell v. Commissioner, 238 F. 2d 148.....	15, 16
Simon v. Commissioner, 248 F. 2d 874.....	15
Stark, Sidney, et al. v. Commissioner, 29 T. C. No. 17.....	22
Stern Bros. & Co. v. Commissioner, 16 T. C. 295.....	22
Tauber, Sheldon, v. Commissioner, 24 T. C. 129.....	19
Taylor v. Commissioner, 70 F. 2d 619.....	15, 20
Texas-Pennsylvania Oil Co. v. Commissioner, 83 F. 2d 518, aff'd 300 U. S. 481.....	20
W. F. Shawver Co. v. Commissioner, 20 B. T. A. 723.....	30
Wolferman. Fred, 10 B. T. A. 285.....	19
Worcester County Trust Co. v. Commissioner, 134 F. 2d 578....	15

BULLETIN

Internal Revenue Bulletin 1957-29, p. 8, Rev. Rul. 57-332.....	22
--	----

RULES

Rules of the Tax Court, Rule 14.....	19
Rules of the Tax Court, Rule 32	19, 32

v.

STATUTES	PAGE
Internal Revenue Code of 1939, Sec. 272.....	1
Internal Revenue Code of 1939, Sec. 275(a).....	33
Internal Revenue Code of 1939, Sec. 1112.....	28
Internal Revenue Code of 1939, Sec. 1141(a).....	2
Internal Revenue Code of 1954, Sec. 7454(a).....	28
Internal Revenue Code of 1954, Sec. 7482(a).....	2
United States Code Annotated, Title 26, Sec. 115(a)	17, 21
United States Code Annotated, Title 26, Sec. 275(c).....	32

INDEX TO APPENDIX

Exhibit A. Balance sheet of Gene Clark, Inc., at May 1, 1946	1
Exhibit B. Balance sheet of Gene Clark, Inc., at April 30, 1947	2
Exhibit C. Balance sheet of Gene Clark, Inc., at April 30, 1948	3
Exhibit D. A computation reflecting the maximum amount of earnings and profits available as a dividend distribution to the petitioners, Gene Clark and Faye Clark, for the calendar years 1946 and 1947.....	4
Exhibit E. A computation reflecting the maximum amount of earnings and profits available as a dividend distribution to the petitioners, Gene Clark and Faye Clark, for the calendar year 1947	5
Exhibit F. Transactions which the Revenue Agent's report manifests, occurred in the calendar year 1948.....	7
Statutes and regulations involved.....	10
List of exhibits.....	17

No. 16010

IN THE

United States Court of Appeals
FOR THE NINTH CIRCUIT

GENE O. CLARK and FAYE CLARK,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of the Decision of the Tax Court of
the United States.

BRIEF FOR THE PETITIONERS.

Opinion Below.

The Findings of Fact and Opinion of the Tax Court are shown in the record at pages 52 to 145 and are designated by the Tax Court as T. C. Memo. 1957-129.

Jurisdiction.

This proceeding involves asserted deficiencies in income taxes for the taxable years 1946 and 1947.

On May 18, 1953 [R. 3], under provisions of Section 272 of the Internal Revenue Code of 1939, the petitioners filed with the Tax Court petitions for redetermination of additional taxes proposed against them on February 20, 1953 [R. 6, 7].

The decision of the Tax Court was entered November 20, 1957 [R. 5]. The case was brought to this Court by Petition for Review filed by the petitioners, Gene O. Clark and Faye Clark, on February 10, 1958 [R. 5]. The jurisdiction of this Court is based on Section 7482(a) of the Internal Revenue Code of 1954 (Sec. 1141(a) of the Int. Rev. Code of 1939 as amended).

Statutes and Regulations Involved.

The applicable statutes and regulations are set forth in the Appendix, *infra*.

Statement of the Case and Questions Presented.

This controversy involves the determination of the income tax liability of Gene O. Clark for the taxable years 1946 and 1947 and the determination of the income tax liability of Faye Clark, his wife, for the year 1947. Separate returns were filed each year by the taxpayers, on income derived from community sources. The Petitioners resided in the State of California during the period here involved.

Gene Clark and his wife, Faye Clark, owned as their community property 70 per cent of the stock of Gene Clark, Inc., a California corporation. This corporation was organized on May 1, 1946, and was on the accrual basis of accounting. Its fiscal year ended on April 30th of each year.

The Commissioner of Internal Revenue determined that Gene Clark, Inc., received taxable income which it failed to report on its returns. He further determined that certain amounts of this alleged unreported corporate income was received by Petitioners as "constructive dividends" during the years 1946 and 1947.

The Tax Court found, without affirmative pleadings on Respondent's part, that Petitioners received more income than was determined by Respondent in his deficiency notices.

Petitioners contend that any unreported corporate income was used for corporate purposes and was not diverted to their own benefit; that Respondent's determinations were arbitrary, capricious, erroneous and invalid; and further, even assuming Respondent's determination of unreported corporate income was correct, there were insufficient earnings and profits available for distribution from Gene Clark, Inc., to cause a distribution thereof, to be ordinary dividends to Petitioners.

Petitioners also contend they cannot now be taxable on income Respondent determined they did not receive.

The principal questions presented are: (1) whether the record of this case supports a finding that Petitioners received "constructive dividends" from Gene Clark, Inc., which they failed to report on their individual tax returns for 1946 and 1947, and, if so, in what amounts; (2) whether Petitioner Gene O. Clark filed fraudulent tax returns for the years 1946 and 1947; (3) whether assessment and collection of any of the deficiencies that may be determined against Petitioner Gene O. Clark for 1946 and 1947 are barred by the Statute of Limitations; (4) whether assessment and collection of any deficiencies that may be determined against Petitioner Faye Clark for 1947 are barred by the Statute of Limitations; and (5) whether the Tax Court was correct in holding that more income than was asserted in Respondent's deficiency notices is taxable to Petitioners?

Specification of Errors.

I.

The Tax Court erred in holding and finding that Petitioners did not sustain their burden of proof for each of the years 1946 and 1947 [R. 84-86].

II.

The Tax Court erred by increasing Petitioners' income beyond the amounts determined in Respondent's deficiency notices [R. 97-99, 122-124].

III.

The Tax Court erred in failing to accrue and deduct taxes, penalties and interest in determining earnings and profits available for distribution to Petitioners from Gene Clark, Inc., at the close of its fiscal year 1948.

IV.

The Tax Court erred in determining that \$74,984.96 was available for distribution and was in fact distributed to its stockholders out of the alleged earnings and profits of Gene Clark, Inc., for its fiscal year ending April 30, 1947 [R. 93].

V.

The Tax Court erred in determining that \$85,827.47 was available for distribution and was in fact distributed to its stockholders out of the alleged earnings and profits of Gene Clark, Inc., for its fiscal year ending April 30, 1948 [R. 123].

VI.

The Tax Court erred in determining that \$44,227.13 was distributed to Petitioners in the calendar year 1946 [R. 106].

VII.

The Tax Court erred in determining that \$45,028.91 was distributed to Petitioners in the calendar year 1947 [R. 123].

(a) The Tax Court erred in its failure to find that out of the alleged earnings and profits of Gene Clark, Inc., \$77,207.15 could not possibly be distributed to its stockholders in 1947.

VIII.

The Tax Court erred in finding that loans by Gene Clark, Inc., in the amount of \$36,149.29 to its stockholders were disguised dividends [R. 77].

IX.

The Tax Court erred in holding and finding that Petitioner Gene O. Clark filed false and fraudulent income tax returns for the years 1946 and 1947, and that a part of the deficiency for each of said years was due to fraud with intent to evade taxes [R. 140, 142].

X.

The Tax Court erred in finding that any deficiencies against Petitioner Gene O. Clark was not barred by the Statute of Limitations for the years 1946 and 1947, and that any deficiencies against Petitioner Faye Clark was not barred by the Statute of Limitations for the year 1947 [R. 142-144].

Summary of Argument.

I.

The Petitioners demonstrated that Respondent's deficiency notices, on their face, were arbitrary and erroneous. The Tax Court recognized this and yet treated such notices as if they were evidence in order to find deficiencies against Petitioners.

II.

The Tax Court cannot support a deficiency assessment by accepting new matter which was surprisingly brought out for the first time in Respondent's Brief, especially where such new matter is inconsistent with Respondent's own determination, and there were no affirmative pleadings on his part.

III.

The Tax Court in determining earnings and profits available for distribution from Gene Clark, Inc., after correctly accruing Federal taxes of the corporation for its fiscal year ending April 30, 1947, erroneously abandoned this concept and failed to accrue taxes of the corporation for its fiscal year ending April 30, 1948. The Tax Court also neglected to accrue fraud penalties set up against the corporation for the year 1947 and interest on the deficiencies set up against the corporation for the year 1947 for its fiscal year ending April 30, 1948.

The propriety of accruing all of such items, taxes, fraud penalties and interest, is well accepted in the law when a determination of earnings and profits available for distribution is being made.

IV.

The evidence and the entire record of this case, including Respondent's deficiency notices and Revenue Agent's Reports, does not support the findings of income to Petitioners in the amounts attributed to them by the Tax Court.

V.

The Tax Court cannot disregard uncontradicted testimony and the books and records of Gene Clark, Inc., in making a finding that a loan of the corporation to its officers was instead a dividend.

VI.

There was absolutely no proof that Petitioner Gene O. Clark received and retained unreported income. The Tax Court, nevertheless, by entertaining mere suspicions, found that the Respondent had met his burden to prove fraud by clear and convincing proof.

VII.

The Statute of Limitations bars any deficiency against Petitioner Gene O. Clark for the years 1946 and 1947; and the Statute of Limitations bars any deficiency against Petitioner Faye Clark for the year 1947.

I.

The Deficiency Notices of the Commissioner Are Arbitrary, Capricious and Erroneous on Their Face. The Determinations Contained Therein Cannot Be Used as Evidence Against Petitioners.

The basis of the Respondent's determination of the tax deficiencies against the Petitioners is contained in the reports of the Revenue Agent respecting the individuals and Gene Clark, Inc., a California corporation. It was stipulated at the trial of these cases that the deficiency notices were based upon the Revenue Agent's Reports [R. 84].

All of the additional income in dispute set up against the Petitioners was alleged to have come from Gene Clark, Inc., through "constructive dividends" [R. 10 and 30].

The investigating agent testified that as used in his reports the term "constructive dividends" meant moneys and property available to the stockholders of the corporation that they had taken for their own uses [R. 475]. During the periods here involved Petitioners owned 70 per cent of the stock and one Archie Koyl and his wife owned 30 per cent of the stock of Gene Clark, Inc.

The Revenue Agent was unable to trace any of the alleged "constructive dividends" to Gene Clark or his wife Faye [R. 471]. Instead, he used what he referred to as the formula method [R. 456]. Pursuant to such formula, he arbitrarily distributed 70 per cent of the alleged "constructive dividends" to Petitioners and 30 per cent to Archie Koyl and his wife [Ex. 3-C].

The attribution of 70 per cent of the alleged additional income of Gene Clark, Inc., to Petitioners was completely unsubstantiated by the agent's investigation. He never talked to Petitioners [R. 305]; was not able to trace any

corporate income, reported or unreported, into Petitioners' personal bank accounts [R. 315]; nor did he complete a computation of Petitioner's net worth [R. 313-314].

The fiscal year of Gene Clark, Inc., ended April 30 of each year. The agent, therefore, had to ascertain what amounts of the alleged earnings and profits were properly allocable to the individuals' calendar years as constructive dividend distributions. Without regard to the dates the transactions took place, the agent arbitrarily allocated 84.259 per cent of the corporate earnings available for distribution for the fiscal year ending April 30, 1947, to the stockholders as income to them in 1946, and 15.741 per cent as income to them in 1947. When asked on cross-examination how he arrived at this allocation, the agent could not explain it [R. 305, 306].

The same unexplainable arbitrary method was used to distribute the available earnings and profits of Gene Clark, Inc., for its fiscal year ending April 30, 1948, only this time the agent attributed 41.523 per cent as income to the stockholders in the year 1947, and 58.477 per cent to them in the calendar year 1948. As above mentioned, 70 per cent of these amounts allocated to each of the calendar years was treated as income of Petitioners. The Revenue Agent's Report [Ex. 3-C], itself shows that out of \$149,-233.83 of earnings and profits available for distribution, \$77,207.15 were 1948 transactions. Exhibit F attached to the appendix of this brief for the convenience of the Court, summarizes these 1948 items.

It is manifest from the foregoing that the Agent's report is arbitrary, contradictory and erroneous on its face.

The Tax Court, however, found the methods used by the Respondent to be reasonable and adopted his formula as

to the fiscal year 1947 [R. 106, 107]. As to the fiscal year ending April 30, 1948, the Tax Court abandoned the Respondent's formula method and after making certain adjustments for the allowance of deductions for accommodation checks [R. 117] and duplicated items [R. 115], attributed all the earnings and profits of the corporation (without regard to items the Respondent found were not available) to the stockholders' calendar year 1947 [R. 124]. No attention was paid to the fact that the Agent's report itself showed \$77,207.15 as taxable events occurring in the year 1948 [see Ex. F attached in the appendix].

It is submitted that it is readily apparent from the foregoing, the finding of the Tax Court in regard to both the calendar years 1946 and 1947 was clearly erroneous.

The lower Court has at the same time used the Revenue Agent's Report as evidence of the amounts of income and rejected other findings of the Respondent, without regard to the pleadings or record in the case. It is incongruous that the Tax Court would accept any part of the Revenue Agent's Report as evidence after it commented during the trial that it was "a calculation that everybody agrees is wrong and has agreed was wrong right straight through" [R. 187].

Substituted Deposits.

One of the principal theories of the Respondent, for setting up additional income to the corporation, was that since Gene Clark, Inc.'s cash receipts records did not always correspond exactly item for item with those amounts deposited in the corporation's bank accounts, for every deposit made that did not precisely equal the amount shown in the cash receipts record, there must have been a like amount withheld by the stockholders of Gene Clark, Inc. [R. 448].

The facts show that every item set out by the Revenue Agent as being a substitution was instead reported by the corporation. The agent admitted on cross-examination [R. 457] that the deposits made in the corporation's bank accounts totalled the exact amount of the items set forth in the revenue agent's report of the corporation, as not being reported.

He further testified [R. 458] that all of the items set forth in the revenue agent's report designated as "substituted" were deposited in the corporation's bank account; that every one of the items denominated as "substituted" were picked up from the corporation's records; that the bank account of the corporation was fully presented in the return filed by the corporation [R. 460, 461]; that the corporation's tax returns show a reconciliation with the books [R. 471]; that included in the reconciliation with the books is the reconciliation with the corporation's bank account, and included in the corporation's bank account are the items set forth as being "substituted" [R. 471, 472].

The items set up by the Revenue Agent as being "substituted" are found on the pages of Exhibit 3-C as follows:

<u>Year</u>	<u>Pages of Exhibit 3-C</u>	<u>Amount</u>
April 30, 1947	46 to 55, incl.	\$14,806.77
April 30, 1948	59 to 66, incl.	49,147.27

The record revealed that Gene Clark, Inc., made a practice of cashing accommodation checks for employees of various business establishments at or near its business location [R. 269]. There was, therefore, a reason for the variance in exact amounts of bank deposits and the cash receipts book. This necessarily bred wide room for error on Respondent's part in the determination of sales, where the corporation ran such checks through its bank account.

(*Bonnie Gladys Gray, et al.* (1953) P-H Memo. T. C. ¶53,000.) The Tax Court recognized this fact but chose to allow a fractional reduction in the alleged unreported sales, instead of throwing out Respondent's determination [R. 117].

Although the lower court applied the "Cohan rule" (see *Cohan v. Commissioner* (2d Cir., 1930), 39 F. 2d 540), to reduce the sales derived from so-called substituted deposits, because of the corporate practice of cashing accommodation checks, it would not apply the *Cohan* rule to allow a further reduction in any amount by reason of money expended for purchases made by Gene Clark [R. 88, 89]. The court found the petitioner Gene Clark had made purchases of the goods which were alleged to be sold and unreported, yet gave credit for none, and applied tax to the gross receipts of such alleged sales. This resulted in a finding contrary to well established practice in tax cases of estimating the expenses where books and records are lacking. An estimate could have been very easily reached by looking to the corporation's tax returns to ascertain the average cost of goods sold and net profit derived from sales.

The lower Court not only accepted as a fact that the amounts deposited and reported were a valid measure for determining a like amount of unreported income [R. 87] but found that 70 per cent of such amounts were distributed to the Petitioners. There was absolutely no evidence introduced to show Petitioners received and retained for their own enjoyment any of such alleged income.

Petitioner Gene Clark testified that whenever he cashed checks belonging to the corporation, such moneys were used to purchase materials for the business, and the cor-

poration eventually ended up with the benefits of all the transactions [R. 330-332, 393].

This testimony was corroborated by the Respondent's witness Frederick Files [R. 266 to 268]. The Tax Court chose to disbelieve this uncontradicted testimony and found not only that Petitioners received 70 per cent of the amount Respondent determined in his deficiency notices was income to them, but that they had in fact received all of the earnings and profits of Gene Clark, Inc., which were set up by the Respondent in the Revenue Agent's Report of Gene Clark, Inc.

Applicable Law.

Where a deficiency notice is based upon an agent's report which does not verify the entire income and which does not show logical reason for arbitrary adjustments, it should be disregarded. *Bruce & Human Drug Co.* (1925), 1 B. T. A. 342; *Alcorn Refining Co.* (1925), 2 B. T. A. 253; *Index Norton Co.* (1925), 3 B. T. A. 90; *Schlemmer & Garber Co.* (1925), 2 B. T. A. 823.

In *Bruce & Human Drug Co.*, *supra*, the agent failed to verify the entire income, either by an examination of all the income and expenses, or by a proof of the opening and closing balance sheets of the taxpayer. Under such circumstances, the Board held for the taxpayer, on the basis that the deficiency notices should be disregarded.

In the instant case, the Agent did not verify the income he set up by way of net worth [R. 313, 314] statements, bank deposit analysis [R. 315], nor did he reconcile his findings as to earnings and profits with opening and closing balance sheets. When asked on cross-examination why he did not use balance sheets, he declared that he was not required to [R. 309, 310].

Petitioners demonstrated, through expert testimony of Paris B. Claypoole [R. 179 to 207] that the deficiency notices were mathematically wrong and legally erroneous in that sound accounting principles were not followed [Exs. 15, 16, 17 and 18]. The Respondent introduced no evidence to show Petitioners' expert was incorrect.

It has been held that where the Tax Court has no other evidence relating to a fact, it cannot disregard credible expert testimony where there was no evidence rebutting such expert testimony. *Belridge Oil v. Commissioner* (9th Cir., 1936), 85 F. 2d 762; *Royal Highlands v. Commissioner* (8th Cir., 1943), 138 F. 2d 240.

While there is a presumption that the Commissioner's findings are correct, when it appears, as in this record it does appear, that the methods pursued by the Commissioner were mathematically and legally erroneous, that presumption no longer avails. *Russell v. Commissioner* (1st Cir., 1930), 45 F. 2d 100.

Petitioners believe that it is evident they sustained their burden and clearly demonstrated the deficiency notices were arbitrary and erroneous on their face.

It must be borne in mind that this case involves a determination of gross income. The Supreme Court in the leading case of *Helvering v. Taylor* (1935), 293 U. S. 507, stated that although the burden is upon the taxpayer to establish the amount of a deduction claimed, when determining gross income all the taxpayer must do is show that the Commissioner's determination was arbitrary and wrong to have it set aside. The taxpayer need not also show the correct amount of income. Judge Learned Hand in the Circuit Court decision of the same case, which was affirmed by the Supreme Court, *Taylor v. Commissioner*,

70 F. 2d 619, pointed out at page 621 that in cases involving the determination of gross income, the taxpayer need not prove a negative—disproving the existence of all possible obligations.

The principles laid down in *Helvering v. Taylor*, *supra*, have been consistently followed. From the multitude of cases that follow the Supreme Court decision, the following are most in point in the instant case: *Gasper v. Commissioner* (6th Cir., 1955), 225 F. 2d 287; *Bryant Heater v. Commissioner* (6th Cir., 1957), 248 F. 2d 939; *Simon v. Commissioner* (8th Cir., 1957), 248 F. 2d 874; *Estate of Belyea v. Commissioner* (3rd Cir., 1953), 206 F. 2d 266; *Federal National Bank of Shawnee, Oklahoma v. Commissioner* (10th Cir., 1950), 180 F. 2d 494; *Durkee v. Commissioner* (6th Cir., 1947), 162 F. 2d 184; *Industrial Trust Co. v. Commissioner* (1st Cir., 1947), 165 F. 2d 142; 1 A. L. R. 2d 144; *Worcester County Trust Co. v. Commissioner* (1st Cir., 1943), 134 F. 2d 578, 580; *Hemphill Schools v. Commissioner* (9th Cir., 1943), 137 F. 2d 961; *J. M. Perry v. Commissioner* (9th Cir., 1941), 120 F. 2d 123; *cf. Showell v. Commissioner* (9th Cir., 1956), 238 F. 2d 148.

The statement of the Court in *Gasper v. Commissioner*, *supra*, at page 288 is particularly appropriate:

“In the light of *Helvering v. Taylor*, *supra*, and *Durkee v. Commissioner*, *supra*, the Commissioner’s determination in the instant case should be set aside since any presumption in its favor disappears once the determination has been proved incorrect; and there is no burden upon the taxpayer to show what the correct amount of the deficiency should have been.”

Also see the dissenting opinion of Judge Pope in *Showell v. Commissioner, supra*, at page 154.

During the trial of this case, it became manifest through the cross-examination of Revenue Agent Phillips, that the deficiency notices were mathematically erroneous and such determinations were based upon an arbitrary formula, without any sort of verification. At no time was the Respondent able to explain how he arrived at his allocation of income between years.

Petitioners introduced into evidence, through their expert, Exhibits showing the determinations to be wrong [Exs. 15, 16, 17, 18] on their face. This evidence was not challenged. Petitioner Gene O. Clark's testimony, which was corroborated by Respondent's witness Fred Files, was not contradicted.

The deficiency notices having been shown to be arbitrary and erroneous and evidence having been so produced, the presumption in favor of the Respondent's determination ceased to exist. Thereafter the case depended wholly upon the evidence. Instead, the Tax Court treated the determinations of Respondent as evidence. Under the principles enunciated by this Court in *Hemphill Schools v. Commissioner, supra*, and *J. M. Perry & Co. v. Commissioner, supra*, the Tax Court acted in a clearly erroneous manner.

II.

The Tax Court, Without Any Substantiating Evidence and Without Affirmative Pleadings on the Respondent's Part, Added More Income Than Was Asserted in Respondent's Deficiency Notices, to Petitioners' Income for the Calendar Years 1946 and 1947.

The Petitioners came into the trial of this case prepared to assail a deficiency based upon alleged additional income due to asserted constructive dividends received from Gene Clark, Inc., a California corporation. The deficiency notices [R. 10 and 30] themselves were sketchy. However, the parties stipulated [R. 84] that the deficiency notices were based upon the Revenue Agent's Report (hereinafter referred to as RAR) of Gene Clark, Inc. [Ex. 3-C].

The Respondent in this report (RAR) determined that Gene Clark, Inc. had an additional net income of \$102,-050.17 for the fiscal year ending April 30, 1947, by reason of certain adjustments to deductions and increases in sales. He next determined that the two stockholders and their wives received some of this additional income of the corporation by way of constructive dividends. Recognizing that dividends can only come from available earnings and profits of the corporation (Sec. 115(a) U. S. C. A., Title 26 (1939 Ed.)) it was determined that the income reported on the corporation's return in the amount of \$30,632.10 and other items totaling \$63,488.47 was not available for distribution, or distributed, out of

the net income of Gene Clark, Inc. for its fiscal year ending April 30, 1947.

Similarly, as to the fiscal year ending April 30, 1948, the Respondent determined that the income reported on the corporation's return in the amount of \$16,726.40, and other items totaling \$6,381.15 was not available for distribution, or distributed, to the stockholders of Gene Clark, Inc.

The investigating revenue agent when cross-examined during the trial conceded that the amounts referred to above should not be considered available earnings to the Petitioners [R. 311, 312].

At no time during the trial was there any indication on Respondent's part that he was changing his position and claiming that said amounts represented additional income to these Petitioner stockholders. There was no evidence introduced at the trial which would substantiate a finding that these additional sums of income were received by the Petitioners. The first time the Petitioners were aware more income than was set up in the deficiency notices was being impressed upon them was when the Respondent made such an assertion in his brief.

Notwithstanding the fact the corporation RAR manifested certain amounts of alleged corporate income were not available for distribution and the individual deficiency notices did not include such amounts as income, and the examining agent concluded and testified he had found such items as not being available for distribution, and the taxpayers' expert witness, Paris B. Claypoole, testified that under sound accounting principles such amounts could not have been either available for distribution, or, in fact, distributed [R. 194, 195, 198, 199, 209] the Tax Court

found without one scintilla of evidence to substantiate such a finding, or any basis in legal reasoning, that the amounts were not only distributable, but were in fact distributed to the stockholders. [R. 97-99, 122-124].

In a case where a similar situation occurred, Chief Judge Murdock stated in *Vincent C. Campbell, et al. v. Commissioner* (1948), 11 T. C. 510, 511:

“The Commissioner in his brief attempts to argue matters inconsistent with his own determination as disclosed in the deficiency notices. He may not do that under the rules of this Court without affirmative pleadings on his part. . . . The petitioners have properly deemed those matters not in dispute.”

Under the Rules of the Tax Court, Rules 14 and 32, the burden of proof is on the Commissioner as to any new matter affirmatively pleaded in his Answer. Certainly, the Respondent cannot escape this burden by merely making new allegations in his brief.

In this case, one important point should not be lost sight of, and that is—even though the amounts in question under sound tax accounting methods were available for distribution (which is not admitted), it does not follow that any of said sums were distributed to Petitioners. The record is completely devoid of evidence for the Respondent in this regard.

In attacking the deficiencies set out in his own notice, Respondent assumed the burden of proving affirmatively the new position upon which he relied, and in the absence of such proof, the Court was left only to consider the Petitioners' attack upon the original determination. *Fred Wolferman* (1928), 10 B. T. A. 285; Also see: *Sheldon Tauber v. Commissioner* (1955), 24 T. C. 129; *Cedar*

Valley Distillery, Inc. (1951), 16 T. C. 870; *Tex.-Penn. Oil Co. v. Commissioner* (3rd Cir., 1936), 83 F. 2d 518, 524, Aff'd 300 U. S. 481 (1937).

The Tax Court in the instant case erred in failing to abide by the concessions of the Commissioner in his deficiency notices. The finding by the Commissioner that certain amounts were not available for distribution together with the uncontradicted testimony of his own witness, Revenue Agent Phillips, removed any issue from the case as to whether said amounts were available or in fact distributed. In this regard, see *Lenox Clothes Ships, Inc. v. Commissioner* (6th Cir., 1943), 139 F. 2d 56, 60.

The Petitioners are under no obligation to support by evidence matters not set up by the Commissioner in his deficiency notice. *Harbor Plywood Corp. v. Commissioner* (9th Cir., 1944), 143 F. 2d 780. The Court stated (at p. 783):

"This Court will not consider in support of a deficiency assessment, reasons not advanced by the Commissioner in his deficiency notice or before the Board of Tax Appeals, especially when the taxpayer has been deprived thereby of the opportunity to present evidence material thereto."

Judge Learned Hand observed in the famous case of *Taylor v. Commissioner*, 70 F. 2d 619, 621, aff'd *Helvering v. Taylor* (1935), 293 U. S. 507.

"The original assessment rested upon a finding, presumptively correct, but the presumption does not extend to other findings which the Commissioner has never made."

III.

The Tax Court Failed to Properly Accrue and Deduct Taxes, Penalties and Interest in Determining Earnings and Profits Available for Distribution.

Gene Clark, Inc., a California corporation, was on the accrual basis of accounting [Exs. 12L, 13M] during the period here involved. Its fiscal year ended April 30th of each year.

The Respondent determined that Petitioners, who owned 70 per cent of said corporation's stock, received from it, constructive dividends which were not reported on their income tax returns during their calendar years 1946 and 1947. Since, as previously stated, dividends are only payable out of the earnings and profits of a corporation (Sec. 115(a), U. S. C. A., Title 26 (1939 Ed.)), it is necessary in determining what is available for distribution, to ascertain the proper charges to be made to the net income of the corporation.

The Respondent erroneously failed to deduct the accrued corporate income taxes which he found to be \$50,419.26 from the \$38,561.70 net earnings and profits available for distribution. If he had done so, nothing would have been available for distribution, as the corporation would have a \$11,857.56 surplus deficit. Any distribution to the stockholders would, therefore, necessarily have to come out of capital (Sec. 115(b), U. S. C. A., Title 26 (1939 Ed.)). Petitioners' Exhibit 15 gives a clear picture of this situation in schedule form.

The Respondent also fell into the same error in determining earnings and profits available for distribution from Gene Clark, Inc.'s net income in its fiscal year 1948. Here, however, he not only failed to deduct corporate

income taxes, but failed to deduct accrued fraud penalties and accrued interest on the deficiencies he set up for fiscal 1947.

The Tax Court, in this case, recognized that accrued taxes should have been deducted from the amounts available for distribution for the corporation's fiscal year ending April 30, 1947 [R. 91, 93], but through the use of unsound mental gymnastics failed to accrue the taxes for Gene Clark, Inc. for its fiscal year ending April 30, 1948 [R. 121-124]. The Court also failed to deduct accrued fraud penalties and interest on the deficiencies set up against the corporation for fiscal 1947, in determining earnings and profits for the corporation's fiscal year ending April 30, 1948.

It is well established that in determining earnings and profits available for distribution (as distinguished from finding net income of a corporation) for an accrual basis corporation, that taxes must be deducted in the fiscal year they are due, *Stern Bros. & Co. v. Commissioner*, 16 T. C. 295; *Estate of Stein v. Commissioner*, 25 T. C. 940; *American Enka Corporation v. Commissioner*, 30 T. C. No. 65; *F. W. Drybrough v. Commissioner* (6th Cir., 1956), 238 F. 2d 735; *Commissioner v. Pacific Affiliate* (9th Cir., 1955), 224 F. 2d 578, aff'g 18 T. C. 1175, cert. den. 350 U. S. 967, that fraud penalties must be deducted in the year they accrue (*i.e.*, when the return is filed which is normally in the year after the taxes are due, *Estate of Stein v. Commissioner*, 25 T. C. 940, acq., Rev. Rule. 57-332, I. R. B. 1957-29, 8; and that interest is accruable and deductible annually from the due date of filing the return, *Sidney Stark, et al. v. Commissioner* (1957), 29 T. C. No. 17.

IV.

Based Upon the Record in This Case the Maximum Amount of Income Arising From "Constructive Dividends" of Gene Clark, Inc. to Petitioner Gene Clark Would Be Only \$4,706.78 for the Calendar Year 1946, and \$953.66 for the Calendar Year 1947. The Maximum Amount of Such Income to Petitioner Faye Clark Would Be \$953.66 for the Calendar Year 1947.

1946

As previously discussed, the Tax Court added \$63,-488.47 to the amount Respondent claimed was available for distribution out of the earnings and profits of Gene Clark, Inc. for its fiscal year ending April 30, 1947. The Court then determined that all of these amounts were distributed to the stockholders of Gene Clark, Inc. One of the items included in this amount of \$63,488.47 was an alleged \$6,000.00 "paper profit" arising from the purchase of a small tract house by Gene Clark, Inc. from one Truman Johnson [R. 94].

The house was held by the corporation until July 31, 1947, at which time it was sold to Petitioner Gene Clark for \$18,862.10, which was the corporation's cost as reflected on its books [Ex. "KK"]. Notwithstanding these facts, the Court found that 84.259 per cent of the \$6,000.00 was in fact distributed to the stockholders Gene Clark and Archie Koyl on a 70/30 per cent basis, respectively, in the year 1946. The most that could have been considered a constructive dividend to the stockholders would have been the fair rental value of said home.

Another item making up the amount the Respondent determined was unavailable for distribution, but which the Court found was available and in fact distributed, was the

disallowance of a bad debt deduction in the amount of \$3,703.50 [R. 96]. Petitioners are at a loss to see how this item could possibly be distributed to them, at all.

An examination of the balance sheet of Gene Clark, Inc. at April 30, 1947, which is attached in the Appendix hereof as Exhibit "B", reveals that the other items set up by the Respondent as not being available for distribution were not in fact available or distributed as they are clearly reflected in the balance sheet of the corporation.

In order to aid the Court in its review of this case, Petitioners have attached in the Appendix of this Brief the balance sheet of Gene Clark, Inc. at its inception, May 1, 1946 [which is attached as Ex. "A" hereto], the balance sheet of Gene Clark, Inc. at the end of its first fiscal year, which ended April 30, 1947 [which is attached as Ex. "B" hereto], and the balance sheet of Gene Clark, Inc. at April 30, 1948 [which is attached as Ex. "C" hereto]. These balance sheets are based upon the tax returns of said corporation, as adjusted by additions and concessions of Respondent in his Revenue Agent's Report [Ex. 3-C].

Assuming that Petitioners did not sustain their burden of proof, an examination of the record as it now stands reveals that the maximum amount of earnings and profits available for distribution out of Gene Clark, Inc. for its fiscal year ending April 30, 1947 was \$15,960.25. This amount was arrived at by accepting the findings of the Tax Court as to earnings and profits available for distribution [R. 91] and deducting therefrom accrued Federal income taxes and the items Respondent conceded in his Revenue Agent's Report [Ex. 3-C] were not available for distribution (said amounts not having been added to Petitioners' alleged unreported income in the deficiency notices). A

clear picture of Petitioners' contentions is contained in Exhibit "D", which is attached to the Appendix of this Brief.

1947

Again assuming that Petitioners did not sustain their burden of proof, an examination of the record reveals the maximum amount of earnings and profits available for distribution to Petitioners for the calendar year 1947 from Gene Clark, Inc. for its fiscal year ending April 30, 1948 was \$511.59. This conclusion is set forth in Exhibit "E" in schedule form, attached to the Appendix hereto. This amount was arrived at by accepting the findings of the Tax Court as to earnings and profits available for distribution [R. 122] and adding thereto the amount of \$63,448.47, which is the amount the Respondent claimed, and Petitioners accepted, as not being available for distribution from Gene Clark, Inc. in its fiscal year 1947. From this total amount, we have deducted the accrued taxes, penalties and interest, together with an actual dividend which was declared in 1948, and the amount Respondent conceded was not available for distribution at the close of the corporation's 1948 fiscal year (said amount not having been added to Petitioners' alleged unreported income in the deficiency notices).

In determining what amounts of the earnings and profits of the corporation could have been distributed to the stockholders in their calendar year 1947 and what amounts could have been distributed to them in 1948, it is necessary of course, to ascertain when the corporate transactions took place. The Revenue Agent's Report [Ex. 3-C] reveals that out of such earnings and profits \$77,207.15 were transactions which occurred between January 1, 1948

and April 30, 1948. This amount was asserted by the Respondent to be additional income of the corporation in its fiscal year ending April 30, 1948. Exhibit "F" is attached to the Appendix of this Brief for the convenience of the Court. It is a list of these 1948 transactions, as taken from the Respondent's Revenue Agent's Report [Ex. 3-C].

It should be clear that this amount could not possibly have been available for distribution in 1947, let alone be distributed to the stockholders of Gene Clark, Inc. in such year. The amount of \$77,207.15 should, therefore, also be deducted from the earnings and profits of the corporation as determined by the Court, prior to any arbitrary allocation of income to the year 1947.

The Tax Court, after a carte blanche acceptance of portions of the Revenue Agent's Report, without substantiating evidence, has overlooked the 1948 transactions set forth in Exhibit 3-C, and has somehow concluded that \$45,028.91 was distributed to the stockholders in 1947 [R. 123]. There was no showing that Petitioners received actual distributions from constructive dividends in any amount for the years involved. The lower Court, however [R. 122-124, incl.], keeps referring to *actual* distributions of \$85,827.47 and then completely abandons the allocation made by the Respondent of attributing 41.523 per cent of the corporation's 1948 earnings and profits to the stockholders' calendar year 1947, and 58.477 per cent thereof to their calendar year 1948.

V.

**The Record Does Not Support the Court's Finding
That a Loan of the Corporation to Its Officers
Was in Substance a Dividend.**

Classification of stockholder withdrawals as loans or as dividends is a question of fact. *Victor Shaken* (1954), 21 T. C. 785; *Al Goodman, Inc.* (1954), 23 T. C. No. 39; *M. Jackson Crispin* (1935), 32 B. T. A. 151.

Petitioner Gene Clark purchased a farm for the intended benefit of Gene Clark, Inc. in 1946 and made a down payment of \$10,000.00 which he had borrowed from Valley Cities Supply Company [R. 350-351].

Mr. Clark returned to California and at a Directors Meeting of Gene Clark, Inc. held on July 22, 1946, reported to the meeting "that on his recent trip to the State of Kansas he had purchased for the corporation, subject to its acceptance or rejection, approximately 400 acres of acreage in the County of Montgomery, State of Kansas, for the total purchase price of \$40,000.00, and that he had paid the sum of \$10,000.00 as the initial down payment" [Ex. 26; R. 344]. After Mr. Clark had made the initial payment, he learned the corporation could not own land in Kansas and the corporation directors thereupon rejected the proposed purchase [R. 343-344]. Mr. Clark felt the farm land was quite a good buy and he made arrangements to purchase it himself [R. 343]. At the meeting of July 22, 1946, the directors of Gene Clark, Inc. authorized a loan to Gene Clark and Archie Koyl of \$21,250.00 [Ex. 26].

Under date of July 31, 1946, an account was opened on the books of the corporation designated "Notes Receivable, Account #110" and the first loan to Clark and Koyl was made in the amount of \$10,000.00 [Ex. 19].

After the purchase of "North Farm", another farm was purchased, designated "South Farm", and placed in the name of Archie Koyl [Ex. 25, R. 345]. In connection with the farm purchases, a charge to "Notes Receivable" in the amount of \$11,406.80 was made on August 31, 1946, and a charge of \$12,420.66 was made on October 31, 1946 [Ex. 19].

Notes receivable in the total amount of \$36,149.29 [Ex. 19] did not constitute a dividend to the stockholders of Gene Clark, Inc. in 1946 or in any other year. There was no surplus or income in the calendar year 1946 out of which a dividend could be paid. The evidence shows that the stockholders always considered the notes as their personal obligations. In an unquestionable arms-length transaction, when Archie Koyl sold his stock in Gene Clark, Inc. to Gene O. Clark on March 29, 1948, a part of the consideration was that Gene O. Clark assume Archie Koyl's obligation to the corporation in the amount of \$10,844.79 [Ex. 29, R. 346-348]. Later on, April 29, 1948, Gene O. Clark paid off \$20,000.00 of Notes Payable [Ex. 19].

VI.

The Respondent Did Not Sustain His Burden of Proof to Prove Fraud.

The Respondent has the burden of proof under the fraud issue, Section 1112 of the Internal Revenue Code of 1939; Section 7454(a) of the Internal Revenue Code of 1954.

Fraud must be established by clear and convincing proof, and a mere preponderance of evidence does not discharge this burden. *Elsye Leiser* (1952), P-H Memo. T. C. Par. 52,276, accord *Griffiths v. Commissioner* (7th Cir., 1931), 50 F. 2d 782; 10 A.F.T.R. 106; *L. Schepp Company* (1932), 25 B. T. A. 419.

Mere suspicion is insufficient proof of fraud. *Elsye Leiser, supra*; *Sharpsville Boiler Works Co.* (1926), 3 B. T. A. 568; *Nicholas Roerich* (1938), 38 B. T. A. 567, *aff'd* (1940), 115 F. 2d 39.

In *J. William Schultze v. Commissioner* (1929), 18 B. T. A. 444, the facts revealed that the petitioner was an admitted bootlegger, who pleaded guilty to a crime in 1923, and filed delinquent returns for the years 1923 and 1924. In holding that the petitioner was not guilty of fraud, Judge Van Fossan stated (at p. 446):

“We may entertain whatever suspicions we choose, or infer whatever probabilities our imaginations dictate, but to find a man guilty of fraud requires more than suspicion or mere probabilities of dereliction. It requires evidence from which an intent to defraud and the fact of defrauding appear.”

As is pointed out in the *Elsye Leiser* case, *supra*,

“. . . (I)n this proceeding, the question of fraud is so intertwined with the alleged receipt of payments by Castleman that the respondent's burden necessarily involves proof that Leiser received all or part of the alleged payments of \$72,370.00.”

Similarly in this case, the question of fraud is so intertwined with the alleged receipt and diversion of moneys of the corporation to the Petitioners' own benefit that the Respondent's burden necessarily involves proof that Petitioners received and retained all or part of the alleged payments.

In the instant case, the Respondent did not come forth with any proof that the taxpayers retained any of the alleged income purportedly received by them. The Revenue Agent never interviewed the Petitioners [R. 305], analyzed

their bank accounts, or prepared net worth statements [R. 314-315]. Contrariwise, Gene Clark testified that whenever he took cash from the corporation or cashed checks belonging to the corporation, that such moneys were used to purchase materials for the business, and the corporation eventually ended up with the benefit of all the transactions [R. 330-332, 393]. Also see, testimony of Fred Files [R. 266-268].

It is abundantly clear from the record that Gene Clark was not acquainted with the niceties of determining income from the varied and sometime complicated transactions he entered into [R. 363-368]. He left the accounting phase of the business to his accountant, Fred Files [R. 334].

Evidence that a taxpayer has acted ignorantly, but without intent to defraud does not justify the imposition of the penalty for fraud. *George L. Rickard v. Commissioner* (1929), 15 B. T. A. 316; *W. F. Shawver Co. v. Commissioner* (1930), 20 B. T. A. 723.

Respondent must show that some part of the deficiencies for each year was due to fraud. *L. A. Meraux v. Commissioner* (1938), 38 B. T. A. 200; *Russell C. Mauch v. Commissioner* (1937), 35 B. T. A. 617, aff'd (3rd Cir., 1940) 113 F. 2d 555.

It is true that Respondent introduced some evidence that Gene Clark, Inc. did not report all of its income. Evidence of unreported corporate income does not prove a taxpayer stockholder received such unreported amounts. The only individual transaction in the record is the "Y. L. Creed transaction". It appeared from the testimony of Y. L. Creed that Petitioner performed plumbing work for four of his houses and that he, Mr. Creed, paid Petitioner \$544.00 in February, 1946; and the balance of \$2,378.50

was allowed as a credit outside of escrow on a house he had sold to Gene Clark in June, 1946 [R. 215-218; Exs. "O", "P"]. The credit was not reported on Petitioners' income tax return. The Tax Court stated in regard to this item [R. 129]:

"If the Creed item were considered as an isolated factor, we would be unwilling to hold that the failure to report it for income tax purposes was sufficient to establish fraud, since it might have been an oversight."

A review of the record reveals that the remainder of Respondent's fraud case is based solely upon suspicion and that he has not proved by clear and convincing evidence that Petitioner Gene Clark knowingly and wilfully received and retained for his own use income that was not reported on his returns for either of the years involved.

VII.

The Respondent Has Not Sustained His Burden of Proof in Regard to Affirmative Allegations in His Answer. Hence the Statute of Limitations Precludes any Deficiency to Petitioners.

As stated above, Respondent has not met his burden of establishing fraud as to Petitioner Gene O. Clark by clear and convincing evidence. The fraud issue in respect to Petitioner Faye Clark is not in issue as Respondent conceded that her returns were not fraudulently filed [R. 53].

We are here concerned only with the Statute of Limitations, with respect to the separate returns of Petitioner Gene Clark for the years 1946 and 1947 and Petitioner Faye Clark for the year 1947. The Court found that the assessment and collection of taxes was barred as to Faye Clark for the year 1946 [R. 142].

If Petitioner Gene O. Clark's return for the year 1946 was not fraudulent, the assessment and collection of taxes for the year 1946 would also be barred as the deficiency notice was mailed to Petitioner more than five years after he filed his return (Sec. 275(c), U. S. C. A., Title 26 (1939 Ed.), [R. 142].)

Respondent relies upon Section 275(c) of the Internal Revenue Code of 1939 which provides for a five year statute of limitations to keep the year 1947 open. This section is applicable only if a taxpayer omits from gross income an amount properly includible therein in excess of twenty-five per cent of the gross income stated in his or her return.

The application of Section 275(c) is raised by Respondent in his Answer, and as a consequence, the burden of proof is upon him. *Lois Seltzer* (1952), 21 T. C. 398; *Rules of the Tax Court No. 32*

The gross income stated on each of Petitioner's returns was \$9,130.51 for the year 1947. Twenty-five (25%) per cent of this amount equals \$2,282.63. Exhibits "D" and "E" reveal that the maximum amounts of gross income that could have been unreported by each of the Petitioners for the year 1947, based upon the record of this case, was \$953.66.

Exhibits "D" and "E" themselves are not based upon the evidence in this case, but only show maximum amounts based upon Respondent's own Revenue Agent's Reports and deficiency notices.

There is not in fact any evidence the Petitioners received and retained for their own use and enjoyment income other than was reported on their returns for the year 1947.

Section 275(a) of the Internal Revenue Code of 1939 is, therefore, applicable and the assessment of the deficiency determined by the Respondent against Petitioners for the year 1947 is barred by the Statute of Limitations.

CONCLUSION.

It is evident from the record of this case that the arbitrary determination of Respondent must be disregarded.

On the basis of the evidence introduced at the trial, the Tax Court should be reversed and the case remanded to said Court with directions to enter judgment for Petitioners.

Dated: September 17, 1958.

Respectfully submitted,

BAIRD & HOLLEY,

By THOMAS A. BAIRD,

Attorneys for Petitioners on Review.

1. The first step is to identify the problem or question that needs to be answered. This involves understanding the context and the specific requirements of the task.





APPENDIX.

Exhibit A.

BALANCE SHEET OF GENE CLARK, INC., AT MAY 1, 1946, SET FORTH IN THE TAX RETURN OF SAID CORPORATION [EX. 12-L, OFFICIAL TRANSCRIPT, PAGE 22].

ASSETS

Cash on Hand	\$ 7,583.10
Accounts Receivable	27,733.77
Inventory	19,623.35
Trucks and Equipment	18,827.56
Buildings and Leasehold	9,732.62
Office Equipment	1,139.77
Land	3,045.00
Deferred Charges	1,523.95
Organization Expense	457.50
	<hr/>
	\$89,666.62
	<hr/>

LIABILITIES

Notes Payable	\$ 5,000.00
Accounts Payable	23,585.05
Reserve for Depreciation	3,351.59
Accrued Taxes and Insurance	2,961.66
Accrued Salaries	2,568.32
Capital Stock	52,200.00
Surplus	—0—
	<hr/>
	\$89,666.62
	<hr/>

Exhibit B.

BALANCE SHEET OF GENE CLARK, INC., AT APRIL 30, 1947,
 BASED UPON THE TAX RETURN OF SAID CORPORATION,
 AS ADJUSTED BY ADDITIONS AND CONCESSIONS OF THE
 COMMISSIONER OF INTERNAL REVENUE IN HIS REVENUE
 AGENT'S REPORT OF GENE CLARK, INC. [EXHIBITS 12-L
 AND 3-C, RESPECTIVELY AND OFFICIAL TRANSCRIPT,
 PAGES 20 AND 23, RESPECTIVELY].

ASSETS

Cash		\$ 41,693.47
Accounts Receivable		23,994.79
Inventory		18,963.81
Other Investments		24,862.10
<u>Fixed Assets</u>		
Trucks and Equipment	\$33,375.00	
Buildings and Leasehold	10,205.50	
Office Equipment	1,765.64	
	<u>\$45,346.14</u>	
Less: Reserve for Depreciation	9,672.51	35,673.63
Land		3,045.00
Due from Officers		39,914.07
Organization Expense		457.50
Deferred Charges		989.97
		<u>\$189,594.34</u>

LIABILITIES

Accounts Payable		\$ 28,697.64
Trust Deed		10,798.45
State Income Tax		2,424.97
Federal Income Tax		50,419.26
Accrued Taxes and Insurance		1,529.89
Accrued Salaries		2,357.24
<u>Reserve for items not available for distribution</u>		
Truman Johnson transaction	\$ 6,000.00	
H. L. Brittian Item	1,860.40	
Reversal of Deferred Income	49,210.15	
Merchandise Account	2,714.42	
Bad Debts	3,703.50	63,488.47
Capital Stock		52,200.00
Surplus (Deficit)		(19,787.16)
		<u>\$189,594.34</u>

Exhibit C.

BALANCE SHEET OF GENE CLARK, INC., AT APRIL 30, 1948,
 BASED UPON THE TAX RETURN OF SAID CORPORATION,
 AS ADJUSTED BY ADDITIONS AND CONCESSIONS OF THE
 COMMISSIONER OF INTERNAL REVENUE IN HIS REVENUE
 AGENT'S REPORT OF GENE CLARK, INC. [EXHIBITS 13-M
 AND 3-C, RESPECTIVELY AND OFFICIAL TRANSCRIPT,
 PAGES 23 AND 20, RESPECTIVELY].

ASSETS

Cash		\$ 29,978.35
Accounts Receivable		17,421.59
Inventory		8,332.24
<u>Fixed Assets</u>		
Trucks and Equipment	\$19,911.60	
Buildings and Leasehold	13,664.44	
Office Equipment	3,416.29	
Less: Reserve for depreciation	11,947.58	25,044.75
Organization Expense		457.50
Deferred Charges		1,037.22
Trust Deeds		27,518.99
		<u>\$109,790.64</u>

LIABILITIES

Accounts Payable		\$ 10,565.70
Dividend Payable		20,000.00
Federal Income Tax		82,803.93
Fraud Penalty for fiscal year 1947		21,942.94
Accrued Taxes and Insurance		1,242.70
<u>Reserve for Items not available for distribution</u>		
Advance on Contract Sales	\$ 5,080.40	
Ben Lang Item	1,300.75	6,381.15
Capital Stock		52,200.00
Surplus (Deficit)		(85,345.78)
		<u>\$109,790.64</u>

Exhibit D.

A COMPUTATION REFLECTING THE MAXIMUM AMOUNT OF EARNINGS AND PROFITS AVAILABLE AS A DIVIDEND DISTRIBUTION TO THE PETITIONERS, GENE CLARK AND FAYE CLARK, FOR THE CALENDAR YEARS 1946 AND 1947, FROM THE NET INCOME OF GENE CLARK, INC., FOR THE FISCAL YEAR ENDING APRIL 30, 1947.

Net income per income tax return [R. 91]		\$ 30,632.10
Adjustments to net income [R. 91]		102,050.17
Adjusted net income [R. 91]		<u>\$132,682.27</u>
Deduct:		
Y. L. Creed transaction [R. 91]	\$ 3,058.50	
Cashing accommodation checks [R. 91]	1,480.67	4,539.17
		<u> </u>
Earnings and Profits Available for Distribution [R. 91]		\$128,143.10
Deduct:		
Accrued Federal Income Tax [R. 91]	\$48,694.38	
Items not available for distribution in the fiscal year April 30, 1947 [Ex. 3-C]	63,488.47	112,182.85
		<u> </u>
Maximum Amount of Earnings and Profits Available for Distribution		\$ 15,960.25

ALLOCATION OF EARNINGS AND PROFITS BETWEEN CALENDAR YEARS 1946 AND 1947.

Gene Clark)		\$ 5,586.09
Faye Clark)	70% [R. 85]	5,586.09
Archie Koyl	30% [R. 85]	4,788.07
		<u> </u>
		\$15,960.25

Gene Clark and Faye Clark's percentage of earnings
and profits applied to the calendar year 1946—
84.259% [R. 85]

Gene Clark and Faye Clark's percentage of earnings
and profits applied to the calendar year 1947—
15.741% [R. 85]

Gene Clark—		
Calendar year 1946—	$\$5,586.09 \times 84.259\% =$	\$ 4,706.78
Faye Clark—		
Calendar year 1946—	$5,586.09 \times 84.259\% =$	4,706.78
Gene Clark—		
Calendar year 1947—	$5,586.09 \times 15.741\% =$	879.31
Faye Clark—		
Calendar year 1947—	$5,586.09 \times 15.741\% =$	879.31

Footnote:

The computation set forth above is based upon the Revenue Agent's Report of Gene Clark, Inc. [Exhibit 3-C] which was stipulated to be the basis of Petitioners' deficiency notices, as adjusted by specific findings of the Tax Court as amplified by legal principles adopted by the Tax Court.

Exhibit E.

A COMPUTATION REFLECTING THE MAXIMUM AMOUNT OF EARNINGS AND PROFITS AVAILABLE AS A DIVIDEND DISTRIBUTION TO THE PETITIONERS, GENE CLARK AND FAYE CLARK, FOR THE CALENDAR YEAR 1947, FROM THE NET INCOME OF GENE CLARK, INC., FOR ITS FISCAL YEAR ENDING APRIL 30, 1948.

Net Income per income tax return [R. 114]		\$ 16,726.40
Adjustments to net income [R. 114]		92,208.62
		<hr/>
Adjusted net income [Ex. 3-C]		\$108,935.02
Deduct:		
Substituted deposits [R. 117]	\$ 3,432.48	
Pacific Pumps, Inc. [R. 115]	1,094.52	4,527.00
	<hr/>	<hr/>
Earnings and Profits Available for Distribution [R. 122]		\$104,408.02
Add:		
Items not available for distribution in fiscal year ending April 30, 1947, but available for distribution in the fiscal year ending April 30, 1948 [Ex. 3-C]		63,488.47
		<hr/>
		\$167,896.49
Deduct:		
Transactions which the Revenue Agent's Report manifests, occurred in the cal- endar year 1948 [Ex. 3-C]	\$77,207.15	
Dividend declared April 30, 1948 [Ex. 3-C]	20,000.00	
Accrued Federal Income Tax	39,675.05	
Fraud Penalty for fiscal year April 30, 1947	21,080.50	
Accrued interest on Assessed Tax and Penalty	3,041.05	
Items not available for distribution at April 30, 1948 [Ex. 3-C]	6,381.15	167,384.90
	<hr/>	<hr/>
Maximum Amount of Earnings and Profits Available for Distribution		\$ 511.59

ALLOCATION OF EARNINGS AND PROFITS.

Gene Clark)			\$ 179.06
Faye Clark)	70%	[R. 85]	179.06
Archie Koyl	30%	[R. 85]	153.47
			<hr/>
			\$ 511.59

ALLOCATION BETWEEN CALENDAR YEARS 1947 AND 1948.

1947	41.523%	[Ex. 3-C]
1948	58.477%	[Ex. 3-C]
		<hr/>
		100%

Gene Clark—Calendar year 1947—\$179.06 x 41.523% = \$74.35

Faye Clark—Calendar year 1947—\$179.06 x 41.523% = 74.35

Footnote:

The computation set forth above is based upon the Revenue Agent's Report of Gene Clark, Inc. [Exhibit 3-C] which was stipulated to be the basis of Petitioners' Deficiency Notices, as adjusted by specific findings of the Tax Court as amplified by legal principles adopted by the Tax Court.

Exhibit F.

TRANSACTIONS WHICH THE REVENUE AGENT'S REPORT
MANIFESTS, OCCURRED IN THE CALENDAR YEAR 1948 [EX-
HIBIT 3-C].

SUBSTITUTED DEPOSITS

<u>Date of Deposit</u>	<u>ABA Number of Item</u>	<u>Unreported Item of Income</u>
January 7, 1948	90-1399	\$ 121.41
January 14, 1948	16-312	136.00
	16-312	1,165.00
	90-1051	140.73
	16-274	64.00
January 10, 1948	90-975	45.00
	90-453	2-77
	16-281	20.50
	90-1111	4.30
	90-1181	58.94
	90-1342	6.95
February 16, 1948	90-934	1,094.52
March 4, 1948	90-1075	307.81
March 13, 1948	90-1320	200.00
	1-23	111.00
March 18, 1948	90-499	5.00
	90-1075	87.50
	90-1075	56.20
	90-499	60.00
	90-177	24.75
	90-928	78.74
March 31, 1948	90-1448	6,670.00
April 9, 1948	11-75	100.00
	90-1305	228.67
	90-1305	213.32
	90-1305	261.34
	90-1305	215.95
April 16, 1948	90-1109	25.00
		<hr/>
		11,775.40
Less:		
Allowed by Tax Court for cashing accommodation checks [R. 117]	\$1,177.54	
Pacific Pumps, Inc. [R. 115]	1,094.52	2,272.06
	<hr/>	<hr/>
		\$ 9,503.34

Footnote:

The Tax Court made a ten percent reduction in substituted deposits to make allowance for cashing accommodation checks. [R. 117.] Net substitutions for the fiscal year April 30, 1948, amounted to \$34,324.84 [Exhibit 3-C]. Of this sum, \$22,549.44 represented calendar year 1947 transactions, and \$11,775.40 represented calendar year 1948 transactions; therefore, the sum of \$11,775.40 has been reduced by ten percent, or \$1,177.54.

Unreported Income Items in Other Bank Accounts, as Alleged in Exhibit 3-C

<u>Date of Deposit</u>	<u>ABA Number of Item</u>	<u>Amount of Item</u>
January 17, 1948	90-1404	\$ 630.00
January 26, 1948	90-1404	630.00
	90-1131	1,902.73
	90-1111	133.95
January 27, 1948	90-994	1,400.00
	90-180	276.75
February 9, 1948	90-1305	22,935.00
Fawn Koyl, Trustee for David T. Koyl, Term Account No. 15,713 Citizens National Bank, Maywood Branch		
February 16, 1948		200.00
Fawn Koyl, Trustee for Rodney S. Koyl, Term Account No. 21268 Citizens National Bank, Maywood Branch		
February 16, 1948		700.00
Archie Koyl Citizens National Bank, Maywood Branch		
January 9, 1948	90-180	92.15
	15-51	100.00
January 22, 1948	90-1051	200.00
	90-1344	154.87
January 26, 1948	90-938	170.00
	90-1075	700.00
February 2, 1948	90-1051	863.00
	90-242	58.60
March 15, 1948	90-960	122.59
March 18, 1948	90-903	100.00
	90-1075	109.75
Clyde R. Clark Farm Account Independence State Bank, Independence		
January 31, 1948		3,074.74
		500.00
Archie Koyl Bell Gardens Bank, Bell Gardens		
January 12, 1948	90-1419	600.00
January 22, 1948	90-1075	1,055.50
February 2, 1948	90-1419	850.00
Mrs. Gene Clark Covina National Bank, Covina		
January 23, 1948		467.95
February 9, 1948		693.13
April 30, 1948		112.83
		242.15
		225.18
		<hr/>
		\$39,300.87

Gain or Loss Computed on Sale of Capital Assets
Exhibit G of Exhibit 3-C

<u>Date of Sale</u>	<u>Asset Sold</u>	<u>Loss on Sale</u>	<u>Gain on Sale</u>
February 17, 1948	Craftsman Drill		\$ 60.00
February 7, 1948	Asset unknown		478.00
February 1, 1948	GMC Pickup		518.27
February 1, 1948	Chev. Pickup	\$ 42.19	
February 1, 1948	Int. Pickup	7.81	
February 1, 1948	Chev. Pickup	72.67	
February 1, 1948	Chev. Pickup	76.43	
February 1, 1948	GMC Pickup		625.20
March 1, 1948	Chev. 4 Dr. Sedan	143.54	
April 30, 1948	Chev. Pickup		53.65
April 30, 1948	Chev. Pickup		230.07
April 30, 1948	Chev. Pickup		412.66
April 30, 1948	Chev. Pickup		209.88
		<hr/>	<hr/>
		342.64	2,587.73
			342.64

Gain on Sale of Assets in calendar year 1948

\$2,245.09

April 30, 1948 Advance on Contract Sales

5,080.40

Other Items of Unreported Income—Schedule 3 of Exhibit 3-C

January 9, 1948	Allen T. Mitchell & Son	\$2,294.50
February 10, 1948	A & F Plumbing & Heating	2,223.76
March 2, 1948	Valley Boulevard Plumbing and Electric Co.	12,000.00
April 21, 1948	Ben Lang	1,558.44
April 30, 1948	Ben Lang (Contra item)	1,300.75
February 12, 1948	Sale of Truck [Exhibit Y]	1,700.00
		<hr/>
		\$21,077.45

SUMMARY

Substituted Deposits	\$ 9,503.34
Unreported Income Items in Other Bank Accounts	39,300.87
Gain on Sale of Assets	2,245.09
Advance on Contract Sales	5,080.40
Other Items of Unreported Income	21,077.45
	<hr/>
Total	\$77,207.15

INTERNAL REVENUE CODE OF 1939.

Section 115 * * *

(a) *Definition of Dividend.*—The term “dividend” when used in this chapter (except in section 201(c)(5), section 204(c)(11) and section 207(a)(2) and (b)(3) (where the reference is to dividends of insurance companies paid to policy holders)) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. In the case of a corporation which, under the law applicable to the taxable year in which the distribution is made, is a personal holding company, or which, for the taxable year in respect of which the distribution is made under section 504(c) or section 506 or a corresponding provision of a prior income-tax law, is a personal holding company under the law applicable to such taxable year, such term also means any distribution (whether or not a dividend as defined in the preceding sentence) to its shareholders, whether in money or in other property, to the extent of its subchapter A net income, less the sum of the following:

(1) The net operating loss credit provided in section 26(c)(1);

(2) The dividend carry-over provided in section 27(c); and

(3) The deduction for amounts for retirement of indebtedness provided in section 504(b).

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113. The preceding sentence shall not apply to a distribution which is a dividend within the meaning of the last sentence of subsection (a).

* * * * *

(d) *Other Distributions from Capital.*—If any distribution made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. This subsection shall not apply to a distribution in partial or complete liquidation or to a distribution which, under subsection (f)(1), is not treated as a dividend, whether or not otherwise a dividend.

Section 275 * * *

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(c) *Omission from Gross Income*.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

Section 276 * * *

(a) *False Return or No Return*.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

Section 293 * * *

(b) *Fraud*.—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

INTERNAL REVENUE CODE OF 1954.

Section 7454 * * *

(a) *Fraud*.—In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary or his delegate.

TREASURY REGULATIONS 111, PROMULGATED UNDER THE
INTERNAL REVENUE CODE OF 1939.

Section 29.115-2

For the purposes of income taxation every distribution made by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits. In determining the source of a distribution, consideration should be given first, to the earnings or profits of the taxable year; second, to the earnings or profits accumulated since February 28, 1913, only in the case where, and to the extent that, the distributions made during the taxable year are not regarded as out of the earnings or profits of that year; third, to the earnings or profits accumulated prior to March 1, 1913, only after all the earnings or profits of the taxable year and all the earnings or profits accumulated since February 28, 1913, have been distributed; and, fourth, to sources other than earnings or profits only after the earnings or profits have been distributed.

If the earnings or profits of the taxable year (computed as of the close of the year without diminution by reason of any distributions made during the year and without regard to the amount of earnings or profits at the time of the distribution) are sufficient in amount to cover all the distributions made during that year, then each distribution is a taxable dividend.² (See section 29.115-1.) If the distributions made during the taxable year exceed the earnings or profits of such year, then that proportion of each distribution which the total of the earnings or profits of

the year bears to the total distributions made during the year shall be regarded as out of the earnings or profits of that year. The portion of each such distribution which is not regarded as out of earnings or profits of the taxable year shall be considered a taxable dividend to the extent of the earnings or profits accumulated since February 28, 1913, and available on the date of the distribution. In any case in which it is necessary to determine the amount of earnings or profits accumulated since February 28, 1913, and the actual earnings or profits to the date of a distribution within any taxable year (whether beginning before January 1, 1936, or, in the case of an operating deficit, on or after that date) cannot be shown, the earnings and profits for the year (or accounting period, if less than a year) in which the distribution was made shall be prorated to the date of the distribution not counting the date on which the distribution was made. The provisions of this section may be illustrated by the following example:

Example.—At the beginning of the calendar year³ 1942, the Corporation had \$12,000 in earnings and profits accumulated since February 28, 1913, the earnings and profits for³ 1942 amounted to \$30,000. During the year it made quarterly distributions of \$15,000 each. Of each of the four distributions made, \$7,500 (that portion of \$15,000 which the amount of \$30,000, the total earnings and profits of the taxable year, bears to \$60,000, the total distributions made during the year) was paid out of the earnings and profits of the taxable year; and of the first and second distributions, \$7,500 and \$4,500, respectively,

were paid out of the earnings and profits accumulated after February 28, 1913, and prior to the taxable year as follows:

<u>Distribution during³ 1942</u>		Portions out of earnings or profits of the taxable year	Portion out of earnings accumulated since Feb. 28, 1913 and prior to taxable year	Taxable amount of each distribution
Date	Amount			
Mar. 10	\$15,000	\$7,500	\$7,500	\$15,000
June 10	15,000	7,500	4,500	12,000
Sept. 10	15,000	7,500	7,500
Dec. 10	15,000	7,500	7,500
Total amount taxable as dividends				\$42,000

Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition, and, if realized, whether prior to or on or after March 1, 1913), is not a dividend within the meaning of Chapter 1.

RULES OF PRACTICE OF THE TAX COURT OF THE
UNITED STATES.

RULE 14, ANSWER.

(a) *Time to answer or move.*—The Commissioner, after service upon him of the petition, shall have 60 days within which to file an answer or 45 days within which to move with respect to the petition. (See Rule 22(a) re service of answer.)

(b) *Form of answer.*—The answer shall be drawn so that it will advise the petitioner and the Court fully of the nature of the defense. It shall contain a specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts upon which the Commissioner relies for defense or for affirmative relief or to sustain any issue raised in the petition in respect of which issue the burden of proof is, by statute, placed upon him. Paragraphs of the answer shall be numbered to correspond to those of the petition to which they relate. The original shall be signed by the Commissioner or his counsel.

(c) *Copies and conformation.*—The original and 3 copies of the answer shall be filed, and each copy shall be conformed.

(d) *Application of Rule to amended answers.*—This Rule shall apply to the filing of answers to amended petitions and to amendments to petitions, except as the Court in a particular case may otherwise direct.

RULE 32. BURDEN OF PROOF.

The burden of proof shall be upon the petitioner, except as otherwise provided by statute, and except that in respect of any new matter pleaded in his answer, it shall be upon the respondent.

EXHIBITS. References are to page numbers in the Official Transcript of Record.

Petitioners' Exhibits	Identified	Offered	Received
1-A—RAR Gene O. Clark	19	19	20
2-B—RAR Gene O. and Faye Clark	19	19	20
3-C—RAR Gene Clark, Inc.	19	19	20
4-D—1945 Return Gene O. Clark	21	21	21
5-E—1946 Return Gene O. Clark	21	21	21
6-F—1947 Return Gene O. Clark	21	21	21
7-G—1945 Return Faye Clark	21	21	21
8-H—1946 Return Faye Clark	21	21	21
9-I—1947 Return Faye Clark	21	21	21
10-J—1948 Return Gene O. Clark and Faye Clark—also amended return	22	22	22
11-K—1949 Return Gene O. and Faye Clark	22	22	22
12-L—1947 Return Gene Clark, Inc.	23	23	23
13-M—1948 Return Gene Clark, Inc.	23	23	23
14-N—1949 Return Gene Clark, Inc.	23	23	23
15—Gene Clark, Inc. Fiscal 1947 —Analysis of Income Available for Distribution to Stockholders Based on Report of RA, D. E. Phillips	26	39	39
16—Fiscal 1947 Gene Clark, Inc. Comparative Analysis of Surplus Based Upon Report of Exami- nation by RA Don E. Phillips and 90 day letter showing Amount Available for Distribu- tion as a Constructive Dividend	39	51	51

Petitioners' Exhibits	Identified	Offered	Received
17—Gene Clark, Inc. Balance Sheets	56	56	56
18—Gene Clark, Inc. Disposition of Income Reported in Return Fiscal Year April 30, 1947	59	59	59
19—General Ledger (4 sheets) Record of Journal Entries (3) sheets)	159	159	159
20-WW—RAR Gene Clark, Inc.	183	183	183
21-XX—Cash Receipts Unidentified FYE 1950 Gene Clark, Inc.	185	185	185
22-YY—Cash Receipts Unidentified FYE 1949 Gene Clark, Inc.	185	185	185
23-ZZ—Cash Receipts Unidentified FYE 1948 Gene Clark, Inc.	185	185	185
24-AAA—Cash Receipts Not Located in Deposits FYE 1947 Gene Clark, Inc.	185	185	185
25—Map	256	256	256
26—Minutes (10 Sheets)	258	259	259
27—Agreement dated Jan. 28, 1949	262	263	264
28—Affirmation of Sale	262	263	264
29—Assumption of Obligation 3-29-48	269	269	269
30—Note 98077 2/5/48	314	315	315
31—Note 98076 2/5/48	314	315	315
32—Check 4602 \$450.00	357	357	357
33—Check 4605 \$102.15	358	358	358
34—Check 4606 \$274.95	359	359	359
35—Check 4607 \$50.00	361	361	361
36—Check 4608 \$50.00	362	362	362
37—Check 4609 \$50.00	363	363	363
38—Check 4610 \$20.00	364	364	364

Petitioners' Exhibits	Identified	Offered	Received
39—Check 4612 \$50.00	364	364	364
40—Check 4613 \$50.00	365	365	365
41—Check 4614 \$195.57	366	366	366
42—Check 4615 \$50.00	366	366	366
43—Check 4616 \$50.00	367	367	367
44—Check 4617 \$50.00	368	368	368
45—Check 4618 \$36.50	369	369	369
46—Check 4619 \$590.36	371	385	386
47—Check 4620 \$50.00	371	371	371
48—Check 4603 \$50.00	372	372	372
49—MFI (offered but not admitted (Income Tax Schedule))	374	374
50—Check 4621 \$50.00	377	377	377
51—Check 4622 \$85.00	378	378	378
52—Check 4623 \$50.00	379	379	379
53—Check 4624 \$50.00	379	379	379
54—Check 4627 \$50.00	380	380	380
55—MFI only	382	383
56—Receipt Montgomery Taxes	382	383	385
57—Cert. of Payments and Assessment (3 sheets)	391	391	391

Respondent's Exhibits

O—Affidavit of Y. L. Creed	69	72	73
P—Check No. 11 Y. L. Creed	70	70	70
Q—Plumbing Contract	76	79	79
R—Plumbing Contract	76	79	79
S—Check 3008 Ben Lang	85	86	86
T—Invoice (2) Ben Lang	85	86	86
U—Check No. 1534 Hamilton Homes, Statement dated 8/14/47 Invoice 8/14/47	88	88	88
V—Check No. 1476 Hamilton Homes Statement 7/9/47	88	88	88
W—Check No. 1539 Hamilton Homes, Invoice dated 2/11/47, Invoice dated 8/26/47, Heaters on Tract Invoice 9/9/46, Invoice 8/29/46	88	88	88
X—Check No. 52, 68, Invoice Sept. 10, 1947	94	97	97
Y—Check No. 3787	94	97	97
AA—Checks 2936, 212, 3351, 3696, 4587, 659, 581, Valley City Supply Co. Invoice 3351, 3696, 4587, 442, 212, Statement In- voice 1/16/47, Invoice 1/18/47, Valley City Supply Invoice— Delivered to Valley Cities	95	98	98
BB—Check No. 537807, Check No. 537806, Check No. 392991, 394131, 395227, 392653	95	98	98
CC—Check No. 2313 Mitchell & Son	95	98	99
DD—Check No. 866, Invoice Jan. 21, 1948	95	98	98

Respondent's Exhibits			
EE—Check No. 2346	95	99	99
FF—Receipt No. 5493, 5492, 5494, 5491	95	99	99
GG—Southern California Investment Co.	96	99	100
HH—Loss on Sale of Property other than capital	96	100	100
II—Receipt Sept. 16, 1947	96	100	100
JJ—Hamilton Homes (4 sheets)	96	100	101
KK—Journal Entries Folio 18	96	101	102
LL—Check No. 16510 Valley Blvd. Plumbing & Electric Co.	103	105	106
MM—Check No. 16561 Valley Blvd. Plumbing & Electric Co.	103	105	106
NN—Recap of Material Purchased and Payment Made from Meis- senbuerg's record	104	105	106
OO—Photostat Receipt 3/2/48	104	105	106
PP—MFI (offered but not ad- mitted) FYE 4/30/47 Gene Clark, Inc. Adjustment to Net Income and Distribution to Share- holders	114	116
QQ—MFI only (offered but not admitted) Stipulation of defic- iency Gene Clark, Inc.	115	116
RR—Story & Sons 1948	121	121	121
SS—Gene Clark, Inc. Sale of Busi- ness Assets 5/1/47 to 4/30/48	121	121	121
TT—Check No. 1774 A & F Plumb- ing & Heating Co., 3 invoices (Receipted)	179	179	180

Respondent's Exhibits

UU—Check No. 1167, 1188, 1160, 1273, Victor Kinsel	179	180	181
VV—J. M. Young Dr. Cr. Acc. Rec. Adv.	179	181	181
BBB—Bank Statement George Meissenbuerg Statement	189	214	214
CCC—Judgment & Commitment	309	309	310

No. 16,010

**To the United States Court of Appeals
for the Ninth Circuit**

WILLIAM O. CLARK AND FAYE CLARK, PETITIONERS

UNITED STATES COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**On Petition for Review of the Decisions of the
Tax Court of the United States**

BRIEF FOR THE RESPONDENT

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Assistant Attorney General.

**LEE A. JACKSON,
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Washington 25, D. C.*

FILED

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INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	3
Summary of argument.....	25
Argument:	
The Tax Court did not err, under the entire record here presented, in sustaining (a) both income tax deficiencies and civil fraud penalties assessed against Gene Clark for his calendar years, 1946 and 1947; and (b) an income tax deficiency assessed against Faye Clark for her calendar year, 1947.....	32
A. The Tax Court did not err in its determination of the deficiencies.....	33
B. The Tax Court did not err in finding and concluding that the Commissioner had sustained his burden of proving fraud..	54
C. Section 275(c) is no bar to the assessment and collection of the deficiencies.....	63
Conclusion	66
Appendix	67

CITATIONS

Cases:

<i>American Pipe & Steel Corp. v. Commissioner</i> , 243 F. 2d 125.....	34
<i>Baird v. Commissioner</i> , 25 T.C. 387.....	45
<i>Bodoglau v. Commissioner</i> , 230 F. 2d 336.....	56
<i>Boyett v. Commissioner</i> , 204 F. 2d 205.....	59
<i>Bryan v. Commissioner</i> , 209 F. 2d 822, certiorari denied, 348 U.S. 912.....	59
<i>Carmack v. Commissioner</i> , 183 F. 2d 1, certiorari denied, 340 U.S. 875.....	55

II

Cases—Continued

Page

<i>Chesbro v. Commissioner</i> , 21 T.C. 123, affirmed, 225 F. 2d 674, certiorari denied, 350 U.S. 995....	37
<i>Chipley v. Commissioner</i> , 25 B.T.A. 1103.....	35
<i>Cohan v. Commissioner</i> , 39 F. 2d 540.....	48, 51, 52
<i>Cohen v. Commissioner</i> , 9 T.C. 1156, affirmed, 176 F. 2d 394.....	56
<i>Davis v. Commissioner</i> , 239 F. 2d 187, certiorari denied, 353 U.S. 984.....	55-56, 59
<i>Drybrough v. Commissioner</i> , 238 F. 2d 735, affirming and reversing, <i>United Mercantile Agencies, Inc. v. Commissioner</i> , 23 T.C. 1105....	52, 53
<i>Goe v. Commissioner</i> , 198 F. 2d 851, certiorari denied, 344 U.S. 897.....	34
<i>Gossett v. Commissioner</i> , 22 B.T.A. 1279, affirmed, 59 F. 2d 365.....	35
<i>Greenwood v. Commissioner</i> , 134 F. 2d 915.....	30, 34
<i>Hague Estate v. Commissioner</i> , 132 F. 2d 775, certiorari denied, 318 U.S. 787.....	34
<i>Halle v. Commissioner</i> , 175 F. 2d 500, certiorari denied, 338 U.S. 949.....	56
<i>Helvering v. Kehoe</i> , 309 U.S. 277.....	55
<i>Helvering v. Nat. Grocery Co.</i> , 304 U.S. 282.....	34
<i>Helvering v. Mitchell</i> , 303 U.S. 391.....	56
<i>Helvering v. Taylor</i> , 293 U.S. 507.....	34, 36
<i>Mauch v. Commissioner</i> , 113 F. 2d 555.....	55
<i>Quock Ting v. United States</i> , 140 U.S. 417.....	59
<i>Rogers v. Commissioner</i> , 111 F. 2d 987.....	56
<i>Simmons, Estate of v. Commissioner</i> , 26 T.C. 409..	45
<i>Snell Isle, Inc. v. Commissioner</i> , 90 F. 2d 481, certiorari denied, 302 U.S. 734.....	34
<i>Spies v. United States</i> , 317 U.S. 492.....	56
<i>Staudt v. Commissioner</i> , 216 F. 2d 610.....	34
<i>Stein, Estate of v. Commissioner</i> , 25 T.C. 940....	48, 51
<i>Stern Brothers & Co. v. Commissioner</i> , 16 T.C. 295	51
<i>United Mercantile Agencies, Inc. v. Commissioner</i> , 23 T.C. 1105.....	52
<i>United States v. Chapman</i> , 168 F. 2d 997, cer- tiorari denied, 335 U.S. 853.....	56

III

Cases—Continued	Page
<i>United States v. Gypsum Co.</i> , 333 U.S. 364, rehearing denied, 333 U.S. 869.....	34, 56
<i>Wilson Bros. & Co. v. Commissioner</i> , 10 T.C. 251, other issues affirmed, 170 F. 2d 423.....	45
Statutes:	
Internal Revenue Code of 1939:	
Sec. 22 (26 U.S.C. 1952 ed., Sec. 22).....	67
Sec. 115 (26 U.S.C. 1952 ed., Sec. 115).....	67
Sec. 275 (26 U.S.C. 1952 ed., Sec. 275).....	68
Sec. 293 (26 U.S.C. 1952 ed., Sec. 293).....	68
Internal Revenue Code of 1954:	
Sec. 7454 (26 U.S.C. 1952 ed., Supp. II, Sec. 7454)	55
Sec. 7482 (26 U.S.C. 1952 ed., Supp. II, Sec. 7482)	34
Miscellaneous:	
Federal Rules of Civil Procedure, Rule 52(a).....	34, 56

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**In the United States Court of Appeals
for the Ninth Circuit**

No. 16,010

GENE O. CLARK AND FAYE CLARK, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**On Petition for Review of the Decisions of the
Tax Court of the United States**

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court (R. 52-145) is not officially reported.

JURISDICTION

This petition for review involves the liability of the taxpayer, Gene O. Clark, for deficiencies in income taxes amounting to \$24,151.53 and statutory additions thereto (50% fraud penalties) in the amount of \$12,075.77, assessed against him for his calendar years 1946 and 1947 (R. 14-15), and the liability of his wife, Faye Clark, for an income tax deficiency assessed against her in the amount of \$12,252.87 for her calendar year 1947 (R. 35).

These deficiencies and penalties were redetermined by the Tax Court in the total decreased amounts of \$20,893.80 and \$10,446.91, respectively, for the taxpayer Gene Clark's calendar years 1946 and 1947 (R. 160), and in the decreased amount of \$9,288.48 for the taxpayer, Faye Clark, for her calendar year 1947 (R. 161). Notices of the deficiencies and statutory additions thereto were mailed to the taxpayers, separately, on February 20, 1953. (R. 10, 30.) On May 20, 1953, within the permitted 90-day period, the taxpayers filed petitions for review with the Tax Court for a redetermination of the deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 6-15, 27-35.) The Commissioner filed answers (R. 16-22, 36-42); the taxpayers filed replies (R. 22, 42); the taxpayers filed motions to amend their petitions (R. 23-24, 43-44) and amended same on April 1, 1955 (R. 25-26); and the Commissioner filed answers to the amended petitions (R. 26, 45). A hearing was held on March 28 through April 1, 1955, at Los Angeles. (R. 46.) The decisions of the Tax Court sustaining the deficiencies and penalties, as adjusted, were entered on November 21, 1957. (R. 160, 161.) Petition for review by this Court were timely filed on February 10, 1958. (R. 162-166, 166-170.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1939.

QUESTION PRESENTED

Did the Tax Court err, under the entire record here presented, in sustaining: (a) Both income tax deficiencies and civil fraud penalties assessed against Gene Clark for his calendar years 1946 and 1947; and (b) an income tax deficiency assessed against Faye Clark for her calendar year 1947.

STATUTES INVOLVED

The pertinent statutes and Regulations are set forth in the Appendix, *infra*.

STATEMENT

The facts, as stipulated (R. 172-175) and found by the Tax Court below (R. 55-83), appear, as follows:

The taxpayers, Gene O. and Faye Clark, are husband and wife, and during the calendar years 1946, 1947 and 1948 resided in Los Angeles County, California. In March 1949, they moved to Independence, Kansas, and for the remainder of the year were residents of Kansas. All income derived by the taxpayers during the years 1946 to 1948, inclusive, was community income. For the calendar years 1946 and 1947, they filed separate income tax returns on the community property basis and for the calendar year 1948, they filed a joint return with the Collector of Internal Revenue of Los Angeles, California. For the year 1949, they filed a joint income tax return with the Collector of Internal Revenue for the District of Wichita, Kansas. (R. 55-56.)

Prior to April 23, 1946, Gene O. Clark (hereinafter sometimes called the taxpayer) and Archie Koyl were associated in a business venture known as Gene Clark Plumbing Company (hereinafter sometimes referred to as the Plumbing Company), consisting of two shops, located in El Monte and Bell Gardens, California, and having a labor force of approximately thirty-five employees. The Plumbing Company was engaged primarily in selling plumbing supplies and rendering plumbing services to building contractors. No certificate for doing business under a fictitious name was filed on behalf of Plumbing Company to show that it was a partnership. (R. 56.)

The taxpayer and Archie Koyl organized a California corporation, Gene O. Clark, Inc., now known as Atlas Pipe and Supply Company (hereinafter sometimes called the corporation), on April 23, 1946,¹ to engage in the wholesale plumbing business. Of the 522 shares of \$100

¹ Although the parties repeatedly refer to the date of incorporation as May 1, 1946, the record shows that the official date of incorporation was April 23, 1946.

par value stock authorized, 364 shares were issued to the taxpayer, president of the corporation, and 157 shares to Archie M. Koyl, vice president. One qualifying share was issued to another individual who is not involved herein. The taxpayer acquired his shares at a cost of \$36,500. The taxpayer's shares represented an ownership interest in the corporation of approximately 70 per cent. (R. 56-57.)

On or about March 29, 1948, the taxpayer purchased the 157 shares of stock owned by Koyl for \$24,714.49. The sale of Koyl's interest therein was consummated by a document designated "Assumption of Obligation," dated March 29, 1948, filed as the taxpayer's Exhibit 29. (R. 57.)

Thereafter, in December 1948, Clark informed Koyl that he desired to sell out his entire interest in Gene Clark, Inc., to Koyl. On or about March 1, 1949, Clark sold all of his stock to the Koyls, 262 shares to Archie and 260 shares to Fawn, a total of 522 shares. (R. 57.)

During the fiscal years ended April 30, 1947, to 1950, inclusive, the proportional stock ownership in Gene Clark, Inc., is summarized as follows (R. 57):

<u>Date</u>	<u>Clark</u>	<u>Koyl</u>
April 23, 1946 to March 31, 1948	70%	30%
March 31, 1948 to March 1, 1949	100%	
March 1, 1949 to April 30, 1950		100% ²

Gene Clark, Inc., commenced its business operations on or about April 23, 1946, occupying the same premises as the Plumbing Company. Within a few months after the formation of the corporation, the inventory of the Plumbing Company and that of the corporation were commingled and were thereafter kept as a single unit. The only employees on the business premises were those of the corporation. No records were kept that could properly reflect business transactions of any plumbing enterprise other than the corporation. The only book kept in the office that had any connection with Plumb-

² Including shares of Fawn Koyl.

ing Company was a check book on the Bank of America in El Monte. No federal tax returns were filed on behalf of Plumbing Company for any period after April 23, 1946. (R. 58.)

Plumbing Company existed, however, for an indeterminate period after the organization of the corporation, solely for the purpose of buying and selling plumbing materials in violation of the then existent regulations of the Office of Price Administration (O.P.A.). This was done because Plumbing Company did not hold any license to do business which could be forfeited if it were found guilty of violating O.P.A. regulations. Plumbing Company was to serve as a front in such transactions for the corporation which did hold a license to do business. (R. 58.)

The corporation kept its books on an accrual method and reported its income on a fiscal year basis beginning with the year ending April 30, 1947. (R. 58.)

After incorporation of the plumbing enterprise, customers would frequently make out checks to Gene Clark, to the corporation or to Plumbing Company. To obviate the resultant confusion, the corporation adopted a rubber stamp showing all three designations in order that it might properly endorse any check. This composite stamp was used throughout the period here in question. (R. 58-59.)

During each of the taxable years in which Clark was an officer and stockholder of Gene Clark, Inc., substantial but undisclosed and undetermined amounts of receipts from sales made by the corporation were neither recorded on its books nor reported on its income tax returns. During the fiscal years involved herein, the net income of Gene Clark, Inc., reported on its returns (the tax liability of which is material here because of its reflection upon the issues involving the taxpayers) the total additions to its net income as found by the revenue agent, and its total net income as so found are as follows (R. 59):³

³ The additions to net income and the total net income here listed were predicated upon the computations contained in a report pre-

Year	Net Income per Returns	Additions to Net Income per Revenue Agent's Report	Total Net Income per Revenue Agent's Report
1947	\$30,632.10	\$102,050.17	\$132,682.27
1948	16,726.40	92,208.62	108,935.02
1949	(4,154.03)	46,575.16	42,421.16

Joint Exhibits 3-C, 1-A, and 2-B are, respectively, the revenue agent's reports on Gene Clark, Inc., for the fiscal years ending April 30, 1947-1949, inclusive; the taxpayers' separate returns for 1945, 1946 and 1947; and the taxpayers' joint returns for 1948 and 1949. (R. 60.)

Up to March 1, 1949 (when he sold out his entire interest to the Koyls), the taxpayer was in general control of the over-all corporate operations and dictated its financial policies. Clark was in full charge of the main office in El Monte. Archie Koyl directed the activities at the shop in Bell Gardens. Virtually all other corporate activities, including the maintenance of corporate records and the disposition of receipts, were under the direct control of the taxpayer. (R. 60.)

Fred Files, comptroller and office manager of the corporation, worked under the immediate supervision and direction of the taxpayer. Files' duties consisted primarily of handling receipts and keeping proper office records. He worked at both shops, keeping one set of books for the entire operation, though consecutively numbered duplicate receipt books were maintained in both shops. When cash was received from a customer, the amount thereof was recorded in the receipt book which was, in substance, merely a memorandum that was later transferred to the "cash receipts" journal in the books

pared by the Commissioner's agent during the investigation of the income tax liability of Gene Clark, Inc., which report (discussed, *infra*), was received in evidence by stipulation of the parties for the purpose of explaining the basis of the Commissioner's ultimate determination, but not as evidence of the facts contained therein.

of account. Cash sales were sometimes totalled daily and sometimes only several times a week. A single "cash receipt" figure was usually recorded in the journal for the total amount of the separate sales. Deposits of the total cash receipts were made in the corporation's bank account and generally recorded weekly in the cash receipts journal. Files, who handled all of the bank deposits of the corporation, regularly deposited all cash receipts of the corporation which were turned over to him for such purpose by Gene Clark. On a number of occasions, however, Gene instructed Files to set aside the cash proceeds from certain sales and to turn such funds over to him without recording the sales on the books. Also, at different times, the taxpayer would give Files checks made out to the corporation by customers for sales, which sales were unrecorded on the corporate books, in exchange for the cash taken by the taxpayer. An undetermined part of such cash proceeds were used by the officer-stockholder to cash checks as an accommodation for neighborhood stores and workmen in relatively small sums ranging up to \$100. There was a substantial but undetermined difference in the amount of cash Files recorded in corporate books or deposited in its bank accounts and the amount of cash sales actually made by the corporation. The aforementioned method of handling cash sales was also the general practice of Plumbing Company and was not altered by the coming into existence of the corporation during the entire taxable period involved herein. (R. 60-61.)

Between May, 1946, and December, 1946, the taxpayer, on behalf of the corporation, frequently sold and shipped plumbing materials from the El Monte yard without any entry being made for the transactions in the corporate records. Some of such shipments represented "trading transactions" or nonprofit exchanges of materials with competitors for mutual convenience. (R. 61-62.)

Subsequent to December, 1946, the taxpayer frequently sold and traded plumbing equipment on behalf of the corporation. He also sold and traded used vehicles.

Files was not supplied with the appropriate sales slips and proceeds on many of these transactions. Sometimes Clark would simply give the comptroller a check, without adequate details connected with the sale, and instruct him to remove the particular asset from the corporate books. (R. 62.)

During 1947, when maximum ceiling price regulations on plumbing supplies were in effect under the Office of Price Administration, Clark engaged in black market activities. When he dealt in such illicit activities, the taxpayer would generally pay an undisclosed amount of cash for the purchase of materials over the price indicated on the invoice. These cash funds were taken from unreported corporate receipts. The over-ceiling cash payment was not recorded on the corporate books as part of the total cost of the illicit purchases. Neither the taxpayer, Plumbing Company, nor the corporation reported the profits from such illegal sales transactions. (R. 62.)

During each of the taxable years in question, the taxpayer also had an arrangement with Keenan Pipe and Supply Company whereby he was able to purchase materials on behalf of the corporation at one-third off for cash. Under this arrangement, indeterminate amounts of such purchases were made and paid for (usually with receipts obtained from unreported corporate sales), the parties agreeing not to keep any records of their cash transactions. (R. 62-63.)

Apart from the foregoing *modus operandi* during each of the years involved herein, Gene Clark, Inc., made numerous purchases of plumbing materials in the normal course of business which were not recorded on the corporate books, but the subsequent sales thereof were likewise unrecorded. Also, in many instances, the profits from such sales were neither reported by the corporation on its income tax returns nor by the taxpayers on their returns for the years in issue. The corporation also rendered plumbing services for building contractors on a number of housing projects during the years in ques-

tion, and the taxpayer failed to record the full receipts therefor on its books. (R. 63.)

Y. L. Creed Transaction

Between December 1945 and March 1946, Gene Clark performed extensive plumbing work for Y. L. Creed, a general contractor, on four houses being constructed in Maywood, California. Creed agreed to pay a total of \$2,922.50 for such services, of which the first payment was made by a check in the sum of \$544, on February 5, 1946. The same day, the check for \$544 was deposited to the account of Gene Clark Plumbing Company, and recorded in the sales of that company. The remaining \$2,378.50 was credited to the taxpayer by Creed in June 1946, on account of the purchase price of a house (5957 Otis Avenue, Maywood, California) which the taxpayer purchased from him for a total consideration of \$8,500. The balance of the purchase price was represented by a trust deed made out in favor of Creed and a cash payment of \$1,400 placed in escrow by Clark. The credit of \$2,378.50 was not reported on the income tax return of Gene Clark or Gene Clark, Inc. The Plumbing Company filed no return for this period. (R. 63-64.) See paragraph (3) under heading "Matters Relating to Earnings and Profits Available for Distribution," *infra*.

Unreported Transactions—Gene Clark, Inc.

On October 5, 1946, Gene Clark, Inc., and Truman Johnson, a building contractor, executed a contract under which the corporation was to supply plumbing materials and services to Johnson on ten new houses in West Covina, California. The contract price set forth in the written contract was \$3,300, but the actual price was \$9,300. (On January 22, 1947, the parties executed another contract for similar services on a housing project, consisting of forty houses being built in West Covina at a cost of \$930 per house or a total of \$37,200.) About the same time it rendered these plumbing services to

Johnson, Gene Clark, Inc., purchased a house from him for a total price of \$22,000. The price per unit of the ten houses to be serviced under the October 5, 1946, contract was \$930 per house. The difference of \$6,000 between the written contract price of \$3,300 and the actual (though unexpressed) contract price of \$9,300 represented part payment on the house which the corporation purchased from Johnson. The corporation was credited by Johnson with the difference of \$6,000 on the purchase of the house in 1946. Likewise, Johnson's books reflected the full cost of the materials and services furnished, including the \$6,000 in question. The transaction was handled in the foregoing manner at the request of the taxpayer. The \$6,000 credit was neither recorded on the books of Gene Clark, Inc., nor reported on the corporate income tax returns for any year involved herein. In September 1947, the corporation sold the house to Clark at an amount which was about \$3,137.90 less than the actual cost. The amount of the selling price to Clark was set up as an account receivable on the books of the corporation. (R. 64-65.)

In the year 1947, the following amounts were received by Gene Clark, Inc., from Hamilton Homes, Inc., for plumbing material and services, which were not included in the sales of Gene Clark, Inc. (R. 65):

<u>Date</u>	<u>Amount</u>
9/10/47	\$1,221.00
9/16/47	2,295.00
7/ 9/47	2,170.00

A receipt for \$8,241.42, dated September 16, 1947, was issued to Gene Clark with the notation "Payment in full for Equity in House at 1825 Vine," and the amount thereof was credited to Gene on the "Accounts Receivable—Officers" account of Gene Clark, Inc., by entry dated September 30, 1947. On September 16, 1947 (the same day the receipt for \$8,241.42 was issued to the taxpayer), the corporation made a bank deposit in its commercial bank

account at Citizens National Bank of Maywood, California, in the amount of \$21,180.51, which included, in addition to an undisclosed amount of cash, two of the three checks (in the respective amounts of \$1,221 and \$2,295) representing unrecorded sales received from Hamilton Homes, Inc. The third check for \$2,170 was deposited by the corporation on July 30, 1947, as part of a deposit in the amount of \$10,016.46. The three checks from Hamilton Homes, Inc., were substituted for other receipts from sales recorded on the corporate books but not deposited. (R. 65-66.)

Gene Clark, Inc., received a check dated September 15, 1947, in the amount of \$1,000 from H. K. Niles, which was not reported in the corporate books as a sale, but was included in the corporation's bank deposit of September 16, 1947, mentioned above, in the amount of \$21,180.51. This check was likewise an item substituted for other sales recorded on the books but not deposited. (R. 66.)

The following checks were also received by the taxpayer on behalf of the corporation for materials and plumbing services (R. 66):

<u>Payable to</u>	<u>Amount</u>	<u>Date</u>	<u>Payor</u>
Gene Clark (endorsed "Gene Clark")	\$1,558.44	4/20/48	Ben Lang
Gene Clark	2,294.50	1/14/48	Allen T. Mitchell & Son
Gene Clark Plumbing Co.	1,158.44	2/10/48	A. & F. Plumbing & Heating Co.

It was stipulated (R. 228, 296) that the above amounts were not entered on the books and records of the corporation as sales, nor were they reported for tax purposes on the income tax returns of the corporation or of the taxpayers for the years in issue. (R. 66-67.)

It was likewise stipulated (R. 295) that during 1948, the taxpayer received the following amounts, totalling \$38,009.74, from Lloyd H. Meissenberg, of George A. Meissen-

burg (Valley Boulevard Plumbing & Electric Company), plumbing contractors, for plumbing materials, which amounts also were not recorded in the corporate records or reported on the income tax returns of either Gene Clark, Inc., or the taxpayers for any of the years involved herein (R. 67):

<u>Method of Payment</u>	<u>Date</u>	<u>Amount</u>	<u>Payable to</u>	<u>Endorsed by</u>
Check	2/9/48	\$22,935.00	Gene Clark	Gene Clark
Check	1/29/48	3,074.74	Gene Clark	Gene Clark
Cash	3/2/48	12,000.00		

Of the total of \$38,009.74 received as above noted, Clark retained approximately 70 per cent and gave Koyl approximately 30 per cent. (R. 67.)

A check in the amount of \$1,700 (Tr. 94-95, 96) received by the corporation (made payable to Gene Clark) in payment for one of its vehicles, was drawn by Walter A. Story on February 12, 1948. There is no evidence in the record that the check was entered on the books of the company. (R. 67.)

On March 4, 1948, the taxpayer received a check (stipulated, R. 295) in the amount of \$6,670 from the Southern California Investment Company for rough plumbing (on some twenty-three houses at \$290 per unit) payable to Gene Clark, Inc. The check for \$6,670 was endorsed "Gene Clark, Inc., Gene Clark" and cashed March 19, 1948. A cashier's check in the amount of \$6,670 payable to Gene Clark, Inc., was acquired the same date and was deposited March 31, 1948, in the commercial bank account of Gene Clark, Inc., at Citizens National Bank, Maywood, as part of an over-all deposit of \$12,816.85. The receipt of the \$6,670 was not recorded as a sale in the records of Gene Clark, Inc., nor was it reported as income by either the corporation or the taxpayers. The deposit of the cashier's check of \$6,670 was in substitution for other receipts recorded on the books of Gene Clark, Inc., but

not deposited in the corporation's bank account. (R. 67-68.)

On March 20, 1948, the day after the cashier's check was acquired, Gene Clark, Inc., received a total amount of \$6,610 in cash from the following four separate transactions, for each of which the corporation comptroller issued a cash receipt. The corporation received \$1,250 in cash from the sale of a 1947 Chevrolet truck. The transaction was reported in the corporation's return for fiscal year 1948 as a sale of assets. The amount of \$1,473.93 in cash was also received from Story and Sons and that sum was credited to their account on the books of the corporation. Likewise, the corporation received the sum of \$2,099.91 from Las Vegas Supply Company for the sale of certain miscellaneous assets which was credited on the corporation books. The amount of \$1,786.16 was received from Clark and credited to him in the "Accounts Receivable—Officers" account. There is no evidence that the cash items totalling \$6,610 (R. 292-293) were deposited in the corporation's bank account as a part of the deposit of March 31, 1948, or at any other time. (R. 68-69.)

Gene Clark, Inc., constructed a swimming pool at La Jolla, California for James M. Young, Jr., and received the following checks (R. 69):

<u>Date</u>	<u>Amount</u>
10/30/47	\$1,672.75
11/26/47	1,672.75
11/ 6/47	1,672.75
1/24/48	1,902.73

The first three checks listed above were credited to the account receivable ledger card of James M. Young. It was conceded on brief before the Tax Court that the last check in the amount of \$1,902.73, endorsed by the taxpayer, was neither recorded on the books of the corporation, deposited in its bank account, nor reported as income on its tax return for fiscal 1948. (R. 68.)

The taxpayer, on behalf of Gene Clark, Inc., received the following check for plumbing material sold by the corporation to the Valley Cities Supply Company (R. 69):

<u>Date</u>	<u>Payable to</u>	<u>Endorsed by</u>	<u>Amount</u>
9/20/47	Gene Clark	Gene Clark, Archie Koyl	\$2,731.54

It was stipulated (R. 295) that the above check was neither entered on the books of Gene Clark, Inc., as sales, nor reported for tax purposes on either the income tax returns of the corporation or of the taxpayers for the years in question. (R. 69.)

"Accounts Receivable—Officers," Farm Purchases

During 1946, Gene Clark took a trip to Kansas to examine some farm land, intending to purchase it for the corporation to own and operate. After locating a farm known as North Farm, in Montgomery County, Kansas, he purchased it for a total price of \$40,000, making a down payment of \$10,000 which he borrowed from the Valley Cities Supply Company. When the directors of Gene Clark, Inc., were advised that the corporation was not permitted to own such land in Kansas, they rejected the proposed purchase of North Farm. The taxpayer then decided to purchase the farm land in his own name, using corporate funds as part of the consideration. As part of his financial arrangements relating thereto, the taxpayer, on July 31, 1946, had set up account #110 on the corporate books designated as "Notes Receivable" and an entry was made indicating a loan of \$10,000 had been extended to Clark and Koyl. Thereafter extensive withdrawals were debited to the account in 1946 in relation to the farm purchases, and will be referred to *infra*. These withdrawals were made by Clark without provision for promissory notes, security or interest. There are two credit items in 1946, which, as explained by journal entry, merely reflect a transfer to another account (Outside Investment—West

Covina Property). There is a debit in 1947 to Valley Cities Supply Company which is balanced by a credit within a month. There is also a debit of \$1,591.83 dated February 28, 1947, which is unexplained. None of the credits purport to be cash payments by Clark (or Koyl) except the \$20,000 item of April 30, 1948, in the so-called trust deeds account which was a spurious credit. The circumstances surrounding it and the use of the "Trust Deeds" as the title of the account are set forth *infra*. (R. 70-71.)

Originally, when it was decided that the corporation would own and operate North Farm, the board of directors had opened an account with the Citizens National Bank of Los Angeles, California, designated "Special Account No. 1," in the amount of \$5,000. However, after it was learned that the corporation could not operate the farms, on December 31, 1946, the \$5,000 deposit in the account was transferred to the "Notes Receivable—Officers" account as a debit to Clark's individual account. (R. 71.)

Soon after the purchase of North Farm, Koyl indicated that he would like to own a farm. The taxpayer thereupon bought another farm in Kansas for Koyl, known as South Farm, consisting of about 350 acres. As part of the purchase price therefor, Clark obtained approximately \$10,000 by selling plumbing materials belonging to the corporation. In addition, on August 31, 1946, a charge to the "Notes Receivable—Officers" account was made in the amount of \$11,406.80, and again on October 31, 1946, another charge of \$12,420.66 was made in connection with the purchase of the farms. (R. 71.)

As of May 1, 1947, the "Notes Receivable" account shows debit balances of \$25,304.50 for Clark and \$10,844.79 for Koyl, totalling \$36,149.29. The balances were in direct proportion to their respective shareholdings in the corporation. (R. 71-72.)

Some time before May 1, 1947, the designation of the "Notes Receivable—Officers" account on the general ledger was scratched out (for some unexplained reason) and

changed to "Trust Deeds." A schedule denominated "Notes Receivable—Officers," attached to the corporation's return for fiscal year 1947, states, *inter alia*, that after it was learned that North Farm in Kansas could not be purchased by Gene Clark, Inc., the corporation extended a loan to the officers and "authorized the Officers to purchase this land in their names. The corporation received in return Trust Deeds and Signed Notes [Sic] as security until such time as the land can be profitably sold" At no time while Clark was affiliated with the corporation did it own any trust deeds, and except for the erroneous heading of the account, the corporate books do not reflect such ownership. (R. 72.)

In 1948, the taxpayers purchased two other farms in Kansas for a total price of \$70,000, and for such purpose borrowed \$28,000 from the Independence Bank in Kansas on February 5, 1948, payable in five years. The loan was repaid September 26, 1950. (R. 72.)

In March 1949, title to South Farm, owned by Koyl, was transferred to Clark. (R. 72.)

Pursuant to the specific instructions of the taxpayer, the comptroller sometimes made entries in the corporate books which did not reflect the true facts or amounts involved in the particular transactions being recorded. Thus, during 1948, when Gene Clark Inc., declared its first and only formal dividend, the taxpayer received a dividend check in the amount of approximately \$20,000 (to be exact \$19,996.17). The taxpayer reported the receipt of the dividend on his joint return for 1948. On April 30, 1948, after Clark received the dividend check, his "Notes Receivable—Officers" account was credited with \$20,000. The taxpayer, however, did not turn back the dividend check to the corporation as a credit toward the account. Instead, Clark turned over to the corporation comptroller customers' checks, substantial in amount, totalling about \$20,000, with instructions to credit the account. (R. 72-73.)

Matters Relating to Earnings and Profits Available for Distribution

The deficiencies in the instant case were predicated upon the computations contained in an exhaustive report prepared by the Commissioner's agent during the investigation of the income tax liability of Gene Clark, Inc., for the fiscal years 1947 through 1950, inclusive, the report being admitted in evidence by stipulation of the parties to show the basis of the Commissioner's determination. Corporate net income and tax liability were computed largely upon the bank deposit method, gross receipts being determined primarily on the basis of unreported sales and deposits in the various bank accounts of the corporation. Also, numerous deductions reported by the corporation on its returns as ordinary and necessary business expenses were disallowed. (R. 73.)

The Commissioner, being unable to ascertain with exactitude the amounts of diverted funds attributable to Clark and Koyl, respectively, during the years in issue, allocated such diversions on the basis of their respective stock ownership in the corporation, 70 per cent of the unreported corporate funds being attributed as informal or constructive dividends to the taxpayers. (R. 74.)

The manner in which respondent determined those amounts ultimately attributed to the officer-stockholders as informal dividends for each of the years in question was to first ascertain the earnings and profits of the corporation, as indicated above, and then to adjust this figure for so-called "unavailable" items, thus arriving at the amount "actually" available for distribution as constructive dividends. (R. 74.)

Many items included in the revenue agents' report were admitted by counsel for the taxpayer to be correct at the time the report was submitted in evidence and in part are set forth in detail above. A number of other items connected with the unreported sales of the corporation were contested by the taxpayer, either at the trial or on brief before the Tax Court. (R. 74.)

The Tax Court's findings of fact with respect to those items relating to earnings available for distribution which were disputed (except for items disposed of because of failure of the taxpayer to sustain the burden of proof and items fully covered above in the Tax Court's findings) are as follows (R. 74-80):

(1) *Corporate earnings per return*

The net income per return of the corporation, as set forth hereinbefore, is properly includible in computing earnings available for distribution as dividends for each of the taxable years in controversy. (R. 75.)

(2) *Substitutions*

As aforementioned, during the years 1946 through 1949, inclusive, substantial amounts of receipts from sales were neither recorded on the books of Gene Clark, Inc., nor reported in its income tax returns. In some instances, no part of the particular sales was recorded or reported. In others, less than the full amount was recorded or reported. One device used was referred to in the testimony as "substituted" sales. The device operated substantially as follows: Cash sales would be made and recorded on the books. Other sales totalling a like amount would be made, for which checks were received in payment, which were not recorded on the books. The proceeds of the latter sales, though not recorded, would be deposited, but the recorded cash sales would not be deposited. As a result, the deposit would equal the recorded sales, but an equal amount of sales would be unrecorded and unreported. (R. 75.)

The taxpayer also cashed checks as an accommodation for neighborhood stores and workmen in relatively small sums ranging up to \$100, and an undisclosed number of such checks were deposited in the various corporate bank accounts. (R. 75.)

Apart from such "accommodation" checks, the aforementioned checks, representing unreported sales, were

“substituted” for the “cash receipts” and deposited in corporate bank accounts, and are includible in corporate gross income. The Tax Court reduced the amount of the substituted items (R. 91) so that the amounts reflected in the revenue agents’ report, and the amounts as adjusted compare as follows (R. 75-76):

<u>Fiscal Year</u>	<u>Amount per Report</u>	<u>Amounts as Adjusted</u>
1947	\$14,806.77	\$13,326.10
1948	35,419.36	30,892.36
1949	8,074.79	7,267.31

(3) *Creed credit allowance*

As noted above, between December 1945 and March 1946, the taxpayer performed plumbing work for Y. L. Creed, a general contractor, on several houses. Creed paid a total of \$2,922.50 therefor, of which the first payment was paid to the Plumbing Company, in the sum of \$544 on February 5, 1946. The balance of \$2,378.50 was credited to the taxpayer by Creed in June of 1946, at which time Clark purchased a house from him for a total consideration of \$8,500. The balance or credit of \$2,378.50 was not reported on the books of the corporation, or on the income tax returns of either the corporation or the taxpayers for any of the years in question. There is no evidence that Koyl received any benefit from this credit. In reconstructing corporate income for fiscal 1947, the revenue agent included as an unreported balance due from Creed the amount of \$3,058.50. The amount of \$3,058.50 was not income of the corporation, and was eliminated from corporate income by the Tax Court. (R. 91.) The credit of \$2,378.50 was income to Clark and his wife on the community property basis and one-half of that amount was attributed to Clark for 1946. (R. 76-77.)

(4) *Truman Johnson credit allowance*

During 1946 Gene Clark, Inc., purchased a house from Truman Johnson, a customer of the corporation, for a

total price of \$22,000, and received a credit allowance of \$6,000 on the purchase price. The \$6,000 credit was not recorded on the books of Gene Clark, Inc., or reported on the corporate income tax returns for any year involved herein. (R. 77.)

(5) *“Notes Receivable—Officers”*

As aforementioned, during the entire period in question the two officer-stockholders of the corporation maintained individual open accounts on the corporate books in the “Notes Receivable - Officers” account, to which extensive withdrawals were charged and partial repayments were credited. (R. 77.)

The net withdrawals in the amount of \$36,149.29 from Gene Clark, Inc., as of May 1, 1947, constituted, in reality, disguised dividend distributions rather than loans to the officers during the taxable years involved herein. (R. 77.)

(6) *Income—deferred sales*

During each of the taxable years in question the corporation entered into contracts with building contractors for the installation of plumbing and received a percentage of the total contract price as the work progressed. When the rough plumbing was installed, the corporation collected 80 per cent of the total contract price from the contractors, of which 30 per cent was carried on the corporate books as deferred income until the contract was completed. (R. 77-78.)

In a schedule attached to its federal income tax return for fiscal 1947, the corporation explained the account as follows (R. 78-79):

DEFERRED INCOME-ADVANCE ON CONTRACT SALES:

This account is based on plumbing contracts not completed. On the installation of rough plumbing, fifty per cent of full contract price is set up as income, in as much as half of the contract terms have been completed. However, after installation of rough

plumbing, eighty per cent of full contract price is collected from customer as per terms of the contract. (50% complete—80% collected). This additional thirty per cent collected from the customer at this period of the contract is carried on the books of Gene Clark Incorporated as deferred income until the contract has been completed. After the installation of finish plumbing has been completed, the remaining fifty per cent of contract price is set up as income and the remaining twenty per cent of contract price is collected from customer. This procedure of accounting has been consistently maintained by Gene Clark Incorporated in order not to overstate income in relation to cost of sales of each contract. At the installation of rough plumbing, it is established that the cost of the contract at this period, consisting mainly of labor, is on the average, fifty per cent of contract cost. Whereas, the cost of the contract on installation of finish plumbing consist mainly of materials, also established to be on the average fifty per cent of contract cost.

The so-called deferred income for fiscal 1947 disclosed in the return, but not included in gross income, was in the amount of \$49,210.15. The revenue agent included the amount in adjustments to corporate income for fiscal 1947 but excluded it from earnings available for distribution in that year, and included it in available earnings for fiscal 1948. (R. 79.)

(7) *Pacific Pump, Inc.*

During fiscal 1948, Gene Clark, Inc., received a check from Pacific Pump, Inc., (of which E. J. Weiss was president) for plumbing supplies in the amount of \$1,094.52. The check was included in corporate sales for 1948, but was improperly designated in the journal ledger as having been received from E. J. Weiss. In reconstructing corporate income for fiscal 1948, the revenue agent erroneously included the check as an unreported sale to Pacific Pump, Inc. (R. 79.)

(8) *Bad debts*

On its tax return for fiscal year 1947, the corporation deducted as bad debts the sum of \$4,874.51 from its gross income. Of this amount, \$3,703.50 was disallowed in fiscal 1947 (no identifiable event establishing worthlessness having been proved by the corporation), and was included as "disallowed bad debts" in adjustments to corporate income for that year. The same sum of \$3,703.50 was then deducted by the revenue agent from total corporate net income available for distribution during fiscal 1947, on the theory that said amount was not actually available for distribution as dividends for that year. During fiscal year 1948, the corporation recovered \$3,216.90 of the above bad debt, and reported this amount on its return. In view of the disallowance of \$3,703.50 as a bad debt deduction for fiscal 1947, the amount recovered (\$3,216.90), together with bad debt deductions allowed by the revenue agent for fiscal year 1948 in the amount of \$1,569.40 (the total of the two items being \$4,786.30), was excluded from net income for fiscal 1948 as "nontaxable income and additional deductions." The amount of \$4,786.30 was then added back to corporate earnings available for distribution during fiscal year 1948. (R. 79-80.)

**Facts Relating to Farm
Expenditures for 1946 and 1947**

In July 1946, after the corporate directors decided not to purchase North Farm, Clark purchased the farm for himself and planted some 300 acres of wheat thereon, which was expected to mature in the spring of 1947. His father, Clyde R. Clark, managed the farm for the taxpayers. Because of flood conditions in the area which destroyed the crop, there was no income from the farm operations in 1946 and 1947. No deductions for farm losses incident to the operations of North Farm were claimed on the taxpayers' individual tax returns for 1946 and 1947. (R. 80.)

The corporation maintained a special account in the Citizens National Bank of Los Angeles (Maywood), Cali-

fornia, in the amount of \$5,000 (which was set up on the corporate books on December 31, 1946, as an account receivable from the taxpayer), and which was used by the taxpayer's father in Kansas to pay certain operating expenses of the North Farm owned by Clark and also the South Farm owned by Koyl. (R. 80-81.)

During 1946 the following checks were drawn on Gene Clark, Inc.'s "Special Account No. 1" and signed by Clyde R. Clark (R. 81):

<u>Date</u>	<u>Amount</u>	<u>Payable to</u>	<u>Item</u>
Oct. 17, 1946	\$274.95	J. W. Griffith	Seed wheat—North Farm
Oct. 17, 1946	102.15	Lewis Griffith	Seed wheat
Nov. 2, 1946	21.00	North End Service Station	Gas and oil
Nov. 9, 1946	195.57	W. A. Thompson	Seed wheat and oats—South Farm
Dec. 6, 1946	590.36	A. M. Eckelberry Co.	Taxes on both farms
Dec. 6, 1946	36.50	Clyde R. Clark	Repairing fences on South Farm

In addition to the above expenditures, between November 8, 1946, and December 13, 1946, salary checks in the total amount of \$950 were drawn on the special account payable to Clyde R. Clark. (R. 81.)

Of the foregoing items, the Tax Court found that the following were ordinary and necessary business expenses of operation of the North Farm for 1946 (R. 81):

Seed wheat	\$274.95
Taxes	223.24
Salary	475.00
	<hr/>
Total—1946	\$973.19

During the calendar year 1947, Clyde R. Clark drew \$85 from the special account payable to E. Pincher for overhauling a truck. The check does not show that it was for the North Farm. Clyde R. Clark also drew \$200 as

salary from the special account in 1947. On December 3, 1947, Gene paid taxes on his North Farm in the amount of \$223.24. For the calendar year 1947, the Tax Court found the following were ordinary and necessary business expenses for the operation of North Farm: Salary \$100; taxes \$223.24 (R. 82.)

The parties stipulated that the taxpayers sustained losses on their farm operations in Kansas during the taxable years 1948 and 1949 in the amounts of \$17,233.05 and \$17,060.52, respectively, and that such losses were to be reflected in the Rule 50 computation. (R. 82.)

Adjusted Basis—Partial Liquidating Dividend

In his statutory notice for 1948, the Commissioner determined that the taxpayer received a partial liquidating dividend from Gene Clark, Inc., in the amount of \$65,095.94 during that year. The Tax Court adjusted this amount. Initially, the Commissioner determined that the adjusted basis of the taxpayer's 522 shares of stock in the corporation was \$52,100. The parties, however, stipulated that the basis of the taxpayer's 522 shares was \$61,214.49. (R. 82.)

Ultimate Findings—Limitations and Fraud

With respect to calendar years 1945 through 1949, inclusive, the statutory notice was mailed to the taxpayers on February 20, 1953. No agreement extending the statute of limitations on assessment or collection was entered into between the parties for the taxable years 1945, 1946, or 1947. With reference to the taxable years 1948 and 1949, the parties have stipulated that the statute of limitations is not an issue. (R. 82-83.)

Each of the returns of Gene Clark for the years 1946 and 1947 was false and fraudulent with intent to evade tax within the meaning of Section 276(a) of the Internal Revenue Code of 1939. A part of the deficiency of Gene Clark for each of the years 1946 and 1947 was due to

fraud with intent to evade tax within the meaning of Section 293(b). (R. 83.)

Faye Clark filed her individual federal income tax return for the calendar year 1946 on March 15, 1947, reporting thereon gross income in the amount of \$14,651.66. She filed her return for the taxable year 1947 on March 15, 1948, and reported gross income in the amount of \$9,130.51. The notice of deficiency for the years 1946 and 1947 was mailed to her on February 20, 1953. The Commissioner concedes that her returns for 1946 and 1947 were not false or fraudulent with intent to evade taxes. (R. 83.)

Faye Clark omitted from gross income in her return for 1947 an amount properly includible therein which is in excess of 25 per cent of the amount of gross income stated in her 1947 return. (R. 83.)

SUMMARY OF ARGUMENT

The Tax Court did not err, under the entire record, in sustaining: (a) Both income tax deficiencies (as adjusted) and civil fraud penalties assessed against Gene Clark for his calendar years, 1946 and 1947; and (b) an income tax deficiency assessed against Faye Clark, Gene's wife, for her calendar year, 1947. Incident to the latter holding, the Tax Court correctly determined that, within the meaning of Section 275(c) of the Internal Revenue Code of 1939, the statute of limitations was not a bar against the valid assessment and collection of the wife's deficiency.

The issues presented are essentially factual and each turns, in the final analysis, on the burden of proof. Under well settled principles, in view of the presumption of correctness attaching to the Commissioner's deficiency assessments, the burden was on the taxpayers to adduce affirmative evidence to prove error in the deficiencies, as assessed and as sustained. Under the entire record, it is altogether clear that the Tax Court did not err in holding that the taxpayers failed utterly to sustain their acknowledged burden and that the deficiencies, as finally determined, should here be affirmed. With respect to the

Section 293(b) fraud penalties assessed against Gene for his calendar years, 1946 and 1947, the burden is on the Commissioner to prove, by clear and convincing evidence, that at least part of the deficiency for each year was due to fraud with intent to evade tax. Here, both the entire record and the specific fraudulent transactions selected by the Tax Court for analysis, as pertaining to calendar year 1946 and calendar year 1947, furnish compellingly clear and convincing proof that the Commissioner adduced more than ample affirmative evidence to sustain his burden. In view of such fraud, no statute of limitations bar, of course, attaches to Gene's deficiency assessments against his calendar years 1946 and 1947. However, with respect to Faye's calendar 1947 deficiency, the notice of deficiency was mailed more than three years but less than five years after the individual return for that year was filed. Accordingly, since the Commissioner, in his answer to the petition, pleaded the validity of the assessment within the five-year statute of limitations provided in Section 275(c) of the 1939 Code, the burden was on the Commissioner to adduce affirmative evidence and prove that Faye omitted properly includible amounts from gross income in her calendar 1947 return, which were in excess of 25 per centum of the amount of gross income stated in such return. Since Faye had filed her 1947 return on a community property basis, she was, of course, liable, deficiency-wise, for one-half of all of the additional income attributable to Gene, as constructive dividends from his controlled corporation, Gene Clark, Inc., for the calendar year, 1947. As indicated above, in proving the fraud attaching to Gene's return for this year, the Commissioner adduced affirmative proof of specific fraudulent transactions during that year which gave rise to at least part of the deficiency assessment. One-half of the additional gross income arising on the specific fraudulent transactions affirmatively proved in support of the Commissioner's burden on the fraud issue was reportable by Faye and included in her calendar 1947 deficiency. This amount, which had been omitted from

Faye's 1947 returns, exceeded 25 per cent of the gross income reported in that return. Accordingly, the Tax Court was correct in holding that Section 275(c) was no bar to the assessment and collection of Faye's calendar 1947 deficiency. Were it not for his fraud, which renders the limitations issue irrelevant to Gene's calendar 1947 deficiency, the same rationale would be clearly applicable to sustain his deficiency for that year.

There is no merit in the taxpayer's various contentions raised against the correctness of the Tax Court's decision. The deficiencies were based in their entirety on constructive dividends determined to have been attributable to Clark on the basis of his 70 per cent controlling stock interest in Gene Clark, Inc., a contract plumbing concern, for its fiscal years ended April 30, 1947, and 1948. Clark was the dominant executive in the corporation and controlled its entire method of operations, including the taking of inventories and the decision as to whether certain sales transactions and the proceeds thereof should be entered by the comptroller on the corporation's books. Under the *modus operandi* maintained throughout the period under review certain identifiable transactions with customers, involving substantial amounts, were unreported on the books and the corporate income arising on such transactions was neither reported on the corporate returns or on the taxpayers' returns. Such unrecorded and unreported transactions included both sales to customers for services performed and sales of materials from inventory, sometimes at overceiling prices. Inventory records were so inadequate as to be all but worthless for purposes of computing income incident to material sales. Substantial amounts of corporate funds were expended to purchase Kansas farms for the corporation's two stockholders, Clark and Koyl. Such diversions of funds were carried on the books as "Notes Receivable—Officers", which the Tax Court held, under all the pertinent facts, were dividends and not loans.

An admitted check substitution practice was followed by the corporation with respect to various customers' ac-

counts throughout the period. Under such practice, Clark directed the bookkeeper to turn certain sales invoices and the cash proceeds of various transactions over to him. The cash proceeds of certain unreported sales would then be included in weekly deposits offsetting, total-wise, the earlier received but undeposited proceeds of recorded sales. Such diversions were claimed by Clark to have been used to make over-ceiling purchases of materials. However, no records of such purchases were available, no evidence other than Clark's self-serving assertions was introduced, and Clark admitted the substituted check practice was his idea, that it prevailed throughout the period, and that he had no records of the inventory purchased or sold, or of the profits admittedly made on over-ceiling material sales and incident to trading transactions with other dealers in supplies. In all but one minor instance, the unreported and unrecorded additional income items (including check substitutions) identified by the agent were either stipulated or uncontested. Expense deduction disallowances were likewise uncontested as additional income items. Since the check substitution practice involved omission to record covering sales invoices on the sales register, thus producing a reconciliation, as to total recorded amounts, in the cash receipts, sales to customers, bank deposits, and sales, per the tax returns, identification of the transactions giving rise to the additional corporate income was achieved through use of the bank deposits method, entailing a detailed matching of items recorded in cash receipts, sales invoices, and bank deposit slips. The questioned transactions were thus identified as non-matching items, *vis-a-vis*, individual sales and the sales proceeds deposited. Affirmative evidence of the questioned transactions was adduced by the Commissioner by calling various participating third-party customers as witnesses. The correctness of the Commissioner's proof as to these additional income items was confirmed both by Clark's admissions and by the taxpayer's stipulations to that effect. No affirmative evidence to the contrary was produced by the taxpayers. Their only non-party

witness, Claypoole, had no knowledge of either the books or records or of the transaction details.

The revenue agent allocated the additional corporate income to Clark for both fiscal years on a stock ownership basis and further allocated the resulting amount to both spouses' calendar years involved, determining that Clark's community share in the fiscal 1947 constructive dividend for calendar year 1946 was \$22,113.56, based on a total corporate distribution for fiscal 1947 of \$79,448.72. In arriving at the total distribution figure, the agent made various adjustments to corporate earnings and profits. For the calendar year, 1948, the agent determined each spouse's allocable additional taxable income to be \$24,750.49, based on total corporate distributions of \$149,233.83. The Revenue Agent's Report supplied the basis for determination. But, as the Tax Court's opinion correctly shows, certain adjustments, both for and against the taxpayer, were necessary in order to arrive at a correct determination of the deficiencies resulting from the clearly indicated and substantially admitted corporate constructive dividends for fiscal 1947 and 1948. Taxpayers' attack on the allocation of the distributed corporate income is without basis. As taxpayers filed returns on a calendar year basis, while the corporation reported on a fiscal year basis ending April 30th, and as it was impossible to determine from the records the actual dates upon which Clark took to his own use cash belonging to the corporation, some allocation was necessary to place the withdrawals from the corporation into taxpayers' proper calendar years. In addition, it was necessary to determine the corporate earnings and profits for each of its fiscal years in order to determine what portion of the withdrawals represented constructive dividends and what portion, if any, represented withdrawals of capital. Taxpayers attack the allocation of the withdrawals from the corporation's fiscal year ending in 1947: 70% of 84.259% thereof as taxpayers' share of the corporation's available earnings to their calendar year 1946, and 70% of 15.741% thereof as income falling within their calendar year 1947.

In this connection the Tax Court, in upholding the allocation, pointed out that the taxpayers, while not admitting any constructive dividends for the period, did not dispute, assuming there were such dividends, an allocation of 70% to Clark and 30% to Koyl according to their proportionate stock interests; that taxpayers had failed to establish that their share, \$44,227.13, was actually less (or greater) than the amount determined. They merely pointed to the fact that only two-thirds of the company's fiscal year was in 1946. The Tax Court then stated that it found no basis for holding that the allocation was arbitrary. That taxpayers made no motion to require the respondent "to file a further and better statement" (Tax Court Rules of Practice, Rule 17(c)(1)), as a basis for challenging the allocation. Taxpayers cited no authorities or reasons to support their theory that the allocation, to be rational, must in this case be proportionate to the number of months of the corporation's fiscal year which falls in the taxpayers' calendar year. The Tax Court then pointed out that the withdrawals from "Notes Receivable—Officers" account, which it held to be dividends, reached the substantial net amount of \$34,557.46 as of December 31, 1946, and increased only \$1,591.83 between that date and April 30, 1947, the end of the corporation's fiscal year. It followed with the statement that the burden is on the petitioner, the record offers some affirmative support for respondent's action in weighing the particular allocation by attributing the larger percentage to 1946, hence petitioner had failed to prove that the allocation was erroneous or arbitrary, and that there was no basis for holding it invalid, citing this Court's decision in *Greenwood v. Commissioner*, 134 F. 2d 915. (R. 106-107.)

The Tax Court then stated that the above relating to 1946 made it apparent that taxpayers' understatement in their 1947 calendar year return of constructive dividends for the fiscal year 1947 was that which it computed—\$8,262.34.

Taxpayers also attack (Br. 9) the percentage of the income of the corporation for the fiscal year ending in

1948 allocated to taxpayers' calendar year 1947. In this connection the Tax Court made adjustments to the amount available for distribution as shown by the Revenue Agent's Report, stating its reasons therefor (R. 110-122). It then stated that other than the adjustments it had made the taxpayers had failed to meet their burden of proving error in the respondent's determination. Accordingly, it accepted its figure of \$85,827.47 as representing total distributions from the corporation for the year 1948. It then held that ~~\$54,028.91~~ was the amount of earnings available for distribution as ordinary dividends and that the balance was to be treated as a liquidating dividend. Hence, as the law treats any distribution as distribution of earnings and profits to the extent available, it upheld the Commissioner's allocation on the ground that Clark's share of available earnings amounted to only \$31,520.44; and that on any appropriate basis of allocation of distributions (\$85,827.47) from the corporation's fiscal years 1948 to the taxpayers' calendar year 1947 (which included eight months of the corporate fiscal year 1948), the distributions attributable to taxpayers for 1947 would be at least sufficient to encompass the amount allocated to them. (R. 123-124.)

Affirmative evidence of Clark's "badges of fraud" pervades the entire record. Specific instances of fraud, showing that at least part of each calendar year's deficiency was due to fraud with intent to evade tax were clearly and convincingly proved by the Commissioner. The statute of limitations is no bar as to Faye Clark. The decisions of the Tax Court should here be affirmed.

ARGUMENT

The Tax Court Did Not Err, Under The Entire Record Here Presented, In Sustaining (a) Both Income Tax Deficiencies And Civil Fraud Penalties Assessed Against Gene Clark For His Calendar Years, 1946 And 1947; And (b) An Income Tax Deficiency Assessed against Faye Clark For Her Calendar Year, 1947

We submit that, under this entire record, the Tax Court's decision (R. 160, 161) entered against both taxpayers, Gene and Faye Clark, should here be affirmed. Specifically, we submit that taxpayers have failed to sustain their burden of proving error in the deficiencies assessed (to the extent sustained below, for both years) and that the Commissioner has clearly and convincingly carried his burden of proving that some part of Gene Clark's respective deficiencies assessed for his calendar years, 1946 and 1947, was due to fraud with intent to evade tax, within the meaning of Section 293(b) of the Internal Revenue Code of 1939. (Appendix, *infra*.) Moreover, we submit that the record herein, viewed in its entirety, furnishes cumulatively compelling support for the Tax Court's findings and conclusions with respect to each and every branch of the composite federal income tax issue raised in this petition for review. Finally, we submit that there is no merit in any of the contentions (Br. 8-33) herein raised by the taxpayers.

Essentially this is a factual case, turning ultimately, in each of its branches, on the trial court's appraisal of the evidence in the light of the respective burdens borne by the responsible parties. The applicable law is well-established. Boiled down to its essentials, the case is basically simple, in that there is a conspicuous absence of affirmative taxpayer evidence which can serve to dispel, in any degree, the presumption of correctness attaching to the Commissioner's assertion of the deficiencies and an overabundance of affirmative Government evidence clearly and convincingly supporting the trial court's finding (R. 83) and conclusion (R. 136, 140, 142) that Gene Clark filed his

calendar years 1946 and 1947 returns with fraudulent intent to evade tax. After meticulously setting out his detailed findings (R. 52-83), the Tax Court judge, below, has painstakingly and authoritatively spelled out his reasoning with respect to both the deficiencies (R. 83-125; 142-145) and the fraud (R. 134-142) here in issue on both an over-all and on an item-for-item basis and has concluded against the taxpayers on both counts. We agree with the Tax Court's conclusions, the basic underlying reasoning, and the applicability of the authorities cited therefore, and respectfully invite the attention of the Court to the detailed transactional analysis therein set forth. While adopting it, in the light of the entire record, as our own, we shall not attempt an extended repetition of the reasoning here but, instead, shall confine our brief to an answer to the specific contentions (Br. 8-33) made by the taxpayers to this Court.

A. The Tax Court did not err in its determination of the deficiencies

There is no merit in the taxpayers' contentions (Br. 8-28) that the Tax Court's findings (R. 58-80) and conclusions (R. 83-125) with respect to the 1946 and 1947 calendar year deficiencies were erroneous. These contentions, singly and collectively, are demonstrably groundless.

In alleging error in the deficiencies, the taxpayers: (a) Chose (throughout their entire argument) to ignore both their affirmative burden of proving error in the deficiency assessments and their patent failure to sustain that burden; and (b) attempt (Br. 11, 17-20, 23-26, Appendix 2-9) to ignore the true significance of the facts, as developed in the record, and to ascribe a significance to the findings which simply does not here obtain.

Essentially, the correctness of the Tax Court's conclusions below finds more than ample support in the record. All of the deficiencies here in issue, represented constructive dividends from Gene Clark, Inc., the corporation, arising by reason of its plumbing business transacted during its first two fiscal years ended April 30, 1947, and 1948.

Clark was the 70 per cent controlling stockholder of the corporation; his associate, Koyle, owned the remaining 30 per cent stock interest. Faye Clark's interest, as a taxpayer, springs from the fact that she and her husband reported their income for calendar years 1946 and 1947 as a community property basis, filing separate returns for those years.

The Commissioner's determination of a deficiency is presumptively correct. *Helvering v. Nat. Grocery Co.*, 304 U.S. 282; *Helvering v. Taylor*, 293 U.S. 507; *Goe v. Commissioner*, 198 F. 2d 851 (C.A. 3d), certiorari denied, 344 U.S. 897; *Snell Isle, Inc. v. Commissioner*, 90 F. 2d 481 (C.A. 5th), certiorari denied, 302 U.S. 734. The burden of proof rests with the taxpayer to establish error in the Commissioner's determination of deficiencies by at least a preponderance of the evidence. *Helvering v. Taylor*, *supra*; *American Pipe & Steel Corp. v. Commissioner*, 243 F. 2d 125 (C.A. 9th); *Greenwood v. Commissioner*, 134 F. 2d 915 (C.A. 9th). On factual issues, such as are presently presented, the Tax Court's determination should not properly be disturbed on review unless clearly erroneous. Here, the Tax Court based its several determinations, in part, upon its appraisal of the credibility of witnesses, including taxpayer Clark, who testified before it. Upon review, due regard is properly accorded this opportunity possessed by the trial court. *United States v. Gypsum Co.*, 333 U.S. 364, rehearing denied, 333 U.S. 869; *Staudt v. Commissioner*, 216 F. 2d 610 (C.A. 4th); *Hague Estate v. Commissioner*, 132 F. 2d 775 (C.A. 2d), certiorari denied, 318 U.S. 787; Rule 52(a), Federal Rules of Civil Procedure; Section 7482(a) of the Internal Revenue Code of 1954 (formerly Section 1141(a) of the 1939 Code). In any event, contrary to the taxpayers' contentions (Br. 8-16), the record, here, furnishes ample support for the Tax Court's findings and conclusions with respect to the deficiencies. Neither does any merit attach to the taxpayers' contentions (Br. 8-20), which are at least made implicitly, that the Tax Court's adjustments made to the revenue

agent's deficiency computations, as urged by the Commissioner below, were arbitrary, capricious or erroneous.

Where, as here, the trial court holds (R. 92-93, 107) that the taxpayer has failed to sustain this burden, and, yet, it appears to the trial judge that errors (both for and against the taxpayer) have been made by the agent in the report which gives rise to the deficiency assessment, the law is clear that such errors may be corrected and that, if the circumstances warrant it, the Commissioner may be affirmed for reasons other than those which he, himself, has assigned. *Chiple v. Commissioner*, 25 B.T.A. 1103, 1105-1106; *Gossett v. Commissioner*, 22 B.T.A. 1279, affirmed, 59 F. 2d 365 (C.A. 4th).

In making his examination of the corporation Revenue Agent Phillips, in the absence of accurate books and records, employed the so-called "bank deposit" method (R. 435-517),⁴ which uncovered glaring discrepancies, item

⁴ The agent analyzed the cash receipts, recorded sales (per the sales journal), and cash deposits in the corporate bank account, with individually recorded cash receipts being matched against individually recorded cash sales for purposes of item identification and individually recorded cash sales, item-wise, being matched against cash deposit items included on the bank deposit slips. Such detailed matching procedure revealed the existence of a cash substitution practice consistently employed by the corporation throughout the fiscal years 1947 and 1948 here involved, and other unrecorded and unreported transactions whereby substantial amounts of cash sales receipts and other property were siphoned off by both Clark and Koyl, the sole stockholders.

The Tax Court found (R. 59-63) that this intentionally followed practice, which was *one* key to the corporation's patent failure to keep accurate books and records, was implemented by the fact that Clark had direct control over the corporate activities, including the corporate records and the disposition of cash receipts. At his direction, certain undeposited cash receipts were turned over to him personally, with the sales giving rise thereto being recorded. The customary practice of making bank deposits on a weekly basis thus permitted the subsequent inclusion of total weekly deposits of the covering cash proceeds of substituted sales which were never recorded or reported on the books or the tax returns. As a result, the *total* deposits would equal the *total* recorded sales; the non-matching recorded but undeposited sales and subsequently deposited *substituted* sales proceeds, per the bank deposit slips, however, reflected, item-wise, amounts of corporate cash diverted by Clark.

wise (R. 449-450), between the sales recorded and the sales proceeds included on the bank deposit slips. The amounts so disclosed as never having been recorded on the corporate books were, in many instances, identifiable, transaction-wise by fiscal year (Findings of Fact, R. 63-73) and, dollar-wise were substantial, constituting the basis for the asserted deficiencies. Contrary to the attempted inference which the taxpayers seek to draw (Br. 11), the fact that total recorded sales, per the books, reconciled with sales reported on the corporation returns amounts, in substance, to a tacit admission that the identical substantial amounts of unrecorded sales proceeds which never were entered on the books were similarly unreported on the tax returns. Moreover, it is a distinction without a difference to argue (Br. 11) that the substituted checks were all recorded, since it is the recording of cash proceeds from unreported sales which furnishes the offsetting entry, accounting-wise, to replace the cash proceeds of earlier reported sales which have been appropriated to the stockholders' avail. Actually, under the facts here obtaining, the establishment of a consistently followed pattern of unrecorded transactions and check substitutions reflecting substantial understatements of income (albeit in undetermined amounts) serves to render the corporation's books and records worthless for purposes of accurately determining income. In such circumstances, as the Tax Court carefully pointed out (R. 86-87), the Commissioner was properly entitled to resort to some reasonably effective method for determining the net income. Under the circumstances here obtaining, absent reliable records and present a pattern of purposeful concealment, the Tax Court was entirely justified in holding, contrary to the taxpayers' contention (Br. 8-10), that the method adopted—*viz.*, bank deposit analysis with allocation of additionally developed corporate income on the basis of stock ownership and further allocation to individual calendar years—reached a result that cannot here be viewed as arbitrary. *Helvering v. Taylor, supra*;

Chesbro v. Commissioner, 21 T.C. 123, 128, affirmed, 225 F. 2d 674 (C.A. 2d), certiorari denied, 350 U.S. 995.

Moreover, the very fact that the "bank deposit" analysis, with allocations, was, here, the only practical and reasonable method available to the Commissioner for purposes of arriving at the asserted deficiencies serves to highlight the lack of merit in the taxpayers' complaint (Br. 13) that no net worth analysis was made. Since the deficiencies here in issue are derivative in the sense that they originate in the corporation it is obvious that the constructive dividends here computed have an independent existence apart from the net worth position of the recipient. Assertion of the amount thus constructively received, coupled with the taxpayers' failure to carry their burden of proving error, is sufficient to sustain the deficiencies so derived. In such a case, the effect of the receipt on the net worth of the stockholder is patently irrelevant.

Acknowledging their burden of proof with respect to the deficiencies (Br. 14), the taxpayers attempt to argue (Br. 14-16) that they have carried their burden. Nothing could be further from the facts. As we have pointed out above the deficiencies were derived essentially from corporate constructive dividends which, in turn, were substantially computed as a result of adding the proceeds of certain identified unreported sales (including substituted items) to fiscal 1947 and 1948 net income. Included also in the revenue agent's computation were a few adjustments representing expense disallowances. Proceeding from the computation in the revenue agent's report, the taxpayers' contentions made at the trial against the presumed correctness of the deficiencies were chiefly raised on a transaction-by-transaction basis, with only selected items of asserted additional corporate income being contested.

There is clearly no merit in taxpayers' reliance (Br. 14, 18) on the so-called "expert" testimony of Witness Paris B. Claypoole and on the allegedly "corroborated" testimony of Gene Clark (Br. 16). This was the principal affirmative testimony adduced by the taxpayers which is

available to them for purposes of sustaining their burden of proving error in the deficiencies. Far from establishing error, this testimony serves in large part to buttress the case for the presumed validity of the assessments. Claypoole, on direct testimony (R. 179-208), did little more than identify certain of the contested items in the revenue agent's report and state the treatment accorded such items by the agent. With respect to the disputed Truman Johnson item of \$6,000 he was of the erroneous opinion (R. 194) that a corporate owned house could not be treated as distributable simply because it was a non-cash asset. With respect to the disputed deferred income item of \$49,210.15, he conceded (R. 195) that the amount might have been paid in in cash, but expressed the opinion that it would not be distributable in 1946 simply because the plumbing on which it had been paid had not been completed in that year. He knew little or nothing (R. 194, 195) about the facts underlying the disputed H. L. Brittain and Bad Debt eliminations made by the agent from distributable fiscal 1947 earnings. He testified (R. 195-196) to the correctness of not including *reported* fiscal 1947 taxable income of \$30,632.10 in distributable earnings for that year. With respect to allocation of the corporation's fiscal 1947 distributable earnings to a stockholder's 1946 calendar year, he expressed the patently erroneous opinion (R. 203-204) that no constructive dividend from fiscal 1947 could be so allocated because it would not be known, during calendar year, 1946, whether there would be any fiscal 1947 earnings available at the year's end.

Claypoole's testimony is not only self-contradictory but serves to underscore taxpayers' failure to sustain their burden of proving error in the deficiencies. When questioned by the trial judge as to his opinion respecting the availability of earnings for distribution in dividends prior to the corporate year's end, he reversed himself and admitted (R. 207) that the only criterion is that there be such available earnings and profits at the conclusion of the first taxable year in order to treat a prior distribu-

tion as an ordinary dividend for tax purposes. On cross examination (R. 208-213), he admitted (R. 208) he had never examined the corporation's books and records, had never demanded (R. 211-212) that he be shown such books, and was testifying (R. 208) only on the basis of an examination of the revenue agent's report and the tax returns. He admitted further (R. 211) that he was not in a position to say whether there had been any actual distributions to the stockholders which were not reflected on the books and records.

With respect to his earlier expressed opinion (R. 195-196) that the fiscal 1947 reported taxable income of \$30,-632.10 was not properly available for distribution, Claypoole reversed himself and admitted (R. 208-211) that the fact that such earnings might be in the form of machinery or equipment or other property would not prevent the amount thereof to be treated as distributable earnings. In short, Claypoole's testimony, viewed in its entirety, not only does not even tend to aid the taxpayers in support of their acknowledged burden of proof but, instead, all but flatly admits the Commissioner's contention and the Tax Court's determination with respect to the availability of sufficient earnings and profits to support constructive dividend treatment of the deficiencies, as finally determined below. It also stands as a concession of the validity of the Tax Court's basic reasoning underlying its inclusion (R. 94-97) of the five disputed items, totaling \$63,488.47, in earnings and profits available for distribution in fiscal 1947.

Proceeding to Gene Clark's testimony (R. 315-394), the conclusion is inescapable that, far from contributing any affirmative support to carrying the taxpayers' burden of proving error in the deficiencies, the effect of this testimony was to shore up the case for their validity, as finally determined. While alleging, on direct examination (R. 315-353), that he used appropriated corporate cash to purchase plumbing supplies at over-ceiling prices, Clark admitted (R. 331) that Files, his bookkeeper, did not know of the amounts which were so expended. He admitted

(R. 330) that he no longer possessed a record which he claimed to have kept on such transactions. He admitted further (R. 332) that he personally took the opening inventory for the corporation and that he had no records (R. 331-332) of the sale of materials from inventory. Additional admissions dealt with: (a) The intermingling (R. 332) of alleged separate inventories of the corporation and its predecessor, Clark Plumbing; (b) the fact (R. 333-334) that alleged trading transactions were unrecorded; (c) the receipt of an unrecorded \$12,000 in cash (R. 336-337) pursuant to an unrecorded sale of plumbing materials; (d) the purchase in his own name and that of his wife, of two Kansas farms (R. 344-346) with corporate funds, in 1946; (e) the existence of a "Notes Receivable—Officers" account on the corporation's books (R. 346) reflecting an indebtedness of his to the corporation in the amount of \$27,518.99,⁵ with the account name (R. 349) later being changed to "Trust Deeds"; (f) the fact (R. 349) that the corporation never owned any trust deeds; and (g) the receipt (R. 351) of a \$20,000 dividend from the corporation which reduced his indebtedness to \$27,518.99.

On cross-examination (R. 353-385), Clark admitted further that: (a) Over-ceiling sales (R. 361-362) at a profit were not included in his income tax returns throughout the period; (b) no books (R. 364) were kept for Clark Plumbing, although he knew a profit was realized on sale of materials attributable thereto; (c) he understood (R. 364-368) the substituted items practice, which was his idea

⁵ The Tax Court found that on May 1, 1947, the net withdrawals from the corporation, as recorded in the "Notes Receivable—Officers" account, were \$36,149.29. (R. 77.) As of December 31, 1946, the net withdrawals in the account amounted to \$34,557.46. (R. 107.) In computing the total corporate constructive dividend for fiscal year 1947, the agent included the \$36,149.29 in additionally determined gross income. (R. 105.) The Tax Court (R. 102-105) held that this \$36,149.29 did constitute dividends and not loans, but, in correcting the corporation's fiscal 1947 distributable income, expressly excluded the item from both income and earnings and profits (R. 105). It stands, however, as one admitted diversionary channel which served to absorb appropriated corporate cash during Clark's calendar year, 1946.

and resulted in sales not being recorded on either the books or the corporate tax returns; (d) he did not account (R. 367) for the profits on substituted item transactions; (e) he understood the difficulty (R. 368) attending examination of unrecorded transactions; (f) while he allegedly kept a pocket book on his material sales (R. 370-371) he never used it for purposes of computing profits and never showed it to Files, his bookkeeper; (g) he instructed Files (R. 374) to turn over all cash to himself; and (h) he gave no note to the corporation (R. 385) when he acquired money to purchase the farms in 1946.

Not only do the taxpayers fail utterly to adduce any persuasive evidence in support of their acknowledged burden of proving error in the deficiencies, as demonstrated above, but, in addition, they have stipulated, at the trial, to the vast majority of the specifically indicated unrecorded transactions (including substituted items) which constituted the substantial basis for the constructive dividends developed, computation-wise, in the revenue agent's report. At the trial, the taxpayers, for all practical purposes, accepted the revenue agent's report as the general backdrop for the deficiencies and concentrated their efforts on contesting specific items which the agent had added to corporate income for fiscal years 1947 and 1948. The proof pattern was a relatively simple one. In connection with the Section 293(b) civil fraud penalty assessments, discussed in Part B, *infra*, it was incumbent on the Commissioner to introduce affirmative evidence in support of his burden of proof on that issue. Accordingly, he introduced the testimony of various third party customers of the corporation who could testify (R. 213-240) to particular transactions and also called Clark's bookkeeper, Frederick W. Files (R. 240-287), who testified to the corporation's practices followed with respect to the keeping of books and records, and Revenue Agent Phillips (R. 287-315),⁶ who testified with respect to the prepara-

⁶ By stipulation (R. 176) the testimony of Revenue Agent Phillips in the companion cases of *Archie M. Koyl, et al. v. Commissioner*, T.C. Docket Nos. 48336, 48337 and 48338, has been made part of the record in this case (R. 435-517).

tion of his report and the inclusion of additional income items in corporate income for fiscal 1947 and 1948. Incident to such testimony by the Commissioner's witnesses, the taxpayers' counsel either allowed the items to stand uncontested or stipulated, in open court, to the agent's income treatment accorded each,⁷ the one exception being a check from Pacific Pumps, Inc., in the amount of \$1,094.52 (R. 79, 115), which had been erroneously included by the agent in fiscal 1948 income. On the basis of the foregoing, insofar as the taxpayers' introduction of evidence in support of their burden of proving error

⁷ Specific transactions stipulated to below by taxpayers' counsel, or uncontested:

<u>Fiscal Year Ended April 30, 1947</u>	<u>Amount</u>	<u>Record Reference</u>
Truman Johnson	\$ 6,000.00	R. 221-222, 225
Y. L. Creed		
(Credit to Clark: \$2,378.50)	3,058.50	R. 216-218
H. L. Brittain	1,860.40	Uncontested
Ben Lang	1,900.90	"
Substituted Items	14,806.77	"
Deferred Income	49,210.15	"
Merchandise Purchases		
(deduction disallowed)	2,714.42	"
Bad Debts		
(deduction disallowed)	3,703.50	"
Other Unreported Items	7,123.36	"
<u>Fiscal Year Ended April 30, 1948:</u>		
Hamilton Homes, Inc.		
(3 items)	5,686.00	R. 230
H. K. Niles	1,000.00	R. 297-298
So. Cal. Investment Co.	6,670.00	R. 295
Other Substituted Items	20,968.84	Uncontested
Valley Boulevard Plumbing & Elec. Co. (3 items)	38,009.74	R. 295
James M. Young, Jr.	1,902.73	R. 69
Other Unreported Items	21,234.80	Uncontested
Allen T. Mitchell & Son	2,294.50	R. 296
A & F Plumbing & Heating	2,223.76	R. 296
Ben Lang	1,558.44	R. 228
Valley City Supplies Co.	2,731.54	Tr. 94; R. 295
Walter A. Story	1,700.00	Tr. 96
Other Uncontested Items	24,130.99	Uncontested

in the deficiency assessments is concerned, the Commissioner's determination would stand substantially intact, as assessed. Under the revenue agent's computations (R A R, Ex. Q, p. 81) the corporate constructive dividend for fiscal year 1947 was \$74,984.96, with 70 per cent of such amount, or \$52,489.47, being treated as a distribution to the Clarks, \$44,227.13 to their calendar years, 1946, and \$8,262.34 to their calendar years, 1947. This produced a deficiency for Gene Clark for his calendar year, 1946, of \$22,113.56, as assessed on the community property basis. Faye Clark's 1946 calendar year is barred by the statute of limitations and is not here in issue.

As for fiscal year 1948, the corporate constructive dividend, per the agent's report, was \$149,233.83, of which amount the portion of Clark's 70 per cent share (\$106,334.59) allocated to the spouses' calendar year, 1947, was \$43,376.22. Adding thereto the \$8,262.34 carried over to calendar year 1947, from fiscal year 1947, and taking into account a partial liquidating dividend of \$2,137.57 computed by the agent, the total amount of the constructive dividend to the Clarks for calendar year 1947 was \$49,500.99, of which amount the deficiency for each spouse was \$24,750.50, as assessed. (R. 14, 34.)

As we have pointed out above, whereas the taxpayers' unsuccessful attempt to prove error in the assessed deficiencies was directed at the computations set forth in the revenue agent's report, the report itself, being stipulated in evidence for the limited purpose of showing the arithmetic basis for the deficiencies (R. 289, 443), served only as a framework for arriving at the correct amount of the deficiencies. Under the stipulation the report does not stand as evidence of the proof of its contents, so as to foreclose either the Commissioner or the Tax Court with respect to the assignment of, and/or correction of, computation errors included therein. Pleading-wise, the only limitation on the Commissioner as a result of the deficiencies assessed on the basis of the report was that a correction of any detected errors could not serve as the basis for *increasing* the deficiencies assessed. Contrary

to the taxpayers' present contention (Br. 19-20), however, no new matter was here pleaded by the Commissioner, although, by terms of the stipulation (R. 289, 443), he was never bound by the contents of the agent's report, concession-wise, no additional deficiencies over and beyond the original deficiencies were ever pleaded. Accordingly, the taxpayers' burden of proof with respect to their contention of error as to the original deficiencies never shifted from their shoulders.

As both the Commissioner and the Tax Court recognized (R. 93), several inadvertant but readily revisable errors were apparent in the agent's computations; their correction amounted to nothing more than a recapitulation of the facts, as accepted by both the parties, amount-wise, and a computation of the corporate and individual tax consequences flowing from these facts. The fact that the Tax Court, in making this recomputation, was able to utilize certain pertinent computation figures in the revenue agent's report springs from the fact that such amounts—*viz.*, income reported on the fiscal 1947 and 1948 tax returns (R. 59), (fn. 3, *supra*), claimed expense deductions disallowed and distributions to the Clarks, as computed by the revenue agent (R. 92, 122, R A R, Ex. A, p. 81)—constitute uncontested items which have either been stipulated or accepted by the taxpayers by the simple procedure of introducing no evidence whatsoever to the contrary. (Neither was the Tax Court bound, absent any credible affirmative evidence adduced to sustain taxpayers' burden of proving error in the deficiencies, to accept or reject the agent's allocation of the fiscal 1947 constructive dividend to Clark's calendar years, 1946 and 1947.⁸

⁸ The preliminary allocation of the constructive dividends between Clark and Koyl on the basis of stock ownership is, of course, entirely reasonable in view of Clark's dominant position of control and his numerous admissions, set forth above, with respect to his intentional adoption of the substituted cash practice employed by the corporation throughout the period under review.

As the Tax Court pointed out (R. 106-107), no basis was presented for treating the agent's fiscal 1947 allocation as arbitrary. The taxpayers were fully aware of the allocation made and, nevertheless, made no motion under Rule 17(c)(1) of the Tax Court Rules of Practice to require the Commissioner "to file a further and better statement". No authorities or reasons for a different allocation formula were advanced. As indicative justification for the fiscal 1947 allocation of 84.259 per cent of Clark's dividend to his individual calendar year 1946, the trial judge pointed out, "if only for suggestive consideration", that withdrawals from "Notes Receivable—Officers" were reported as \$34,557.46 at December 31, 1946, and increased only \$1,591.83 between that time and April 30, 1947. Taking into account both the taxpayers' utter failure to carry their burden of proof and the existence of such affirmative record support for the weight accorded calendar year 1946 in the agent's allocation, the Tax Court concluded (R. 107), contrary to the taxpayers' contentions (Br. 8-10, 23-25, Exs. A and B, Appendix 1, 2), that they had failed to prove error in the fiscal 1947 constructive dividend allocation.

Moreover, on the factual issue as to whether Clark's allocable portion of the \$36,149.29 "Notes Receivable—Officers" account represented the receipt of additional fiscal 1947 dividends or a true "loan" (*Wilson Bros. & Co. v. Commissioner*, 10 T.C. 251, other issues affirmed, 170 F. 2d 423 (C.A. 9th)), the Tax Court concluded, on balance (R. 102-105) and contrary to the taxpayers' contention raised herein (Br. 27-28), that, apart from corporate formalities and adverse book entries, the surrounding facts and circumstances—*viz.*, withdrawals in proportion to stock ownership, absence of any notes or trust deeds, etc.—indicate an officer-stockholder-director intent that they were dividends (*Baird v. Commissioner*, 25 T.C. 387; *Estate of Simmons v. Commissioner*, 26 T.C. 409).

Despite this buttressing support for the weighted fiscal 1947 allocation, which, if so treated, would increase the constructive dividend from \$79,448.72 (R. 93) to

\$115,598.01, the Tax Court (R. 105) expressly eliminated the \$36,149.29 from both fiscal 1947 additional net income and available earnings. In point of fact the record expressly refutes the taxpayers' implication (Br. 28) that Clark on April 29, 1948, paid \$20,000 out of his own pocket on this account. His bookkeeper, Files, testified (R. 281-282) that, on April 30, 1948, the corporation distributed a \$20,000 cash dividend to Clark, as the then 99 per cent stockholder; that Clark never returned the check to the corporation for credit against his alleged account liability; and that Clark did give Files "other checks" (*viz.*, substituted items) in the amount of \$20,000, which was credited against his "Notes Receivable—Officers" account.

Moreover, contrary to the taxpayers' contention (Br. 19) that the determined constructive dividends were not distributed to Clark, the Tax Court's factually sound conclusion that the \$36,149.29 constituted dividends (R. 104-105) clearly indicates that a substantial portion of the constructive dividend was expended during calendar year 1946, for the farms in Kansas. However, it is pertinent to point out that it is the establishment of the availability of the constructive dividends to the taxpayers' use which is controlling with respect to taxability as income rather than the traceability of the diverted corporate funds into the taxpayers' respective pockets. In other words, Clark's own admissions that he kept the proceeds of recorded but undeposited sales qualifies such diverted proceeds as portions of the taxable constructive dividend, even though the examining agent cannot prove what Clark did with the appropriated cash.

With respect to the corporation's fiscal year 1947, the Tax Court, after careful analysis, determined (R. 93) that the total constructive dividend, after adjustment, was \$79,448.72. Since this amount exceeded the \$74,984.96 figure used by the Commissioner (R A R, Ex. Q, p. 81) as the basis for Clark's fiscal 1947 constructive dividend, the Tax Court, absent any affirmative proof of error advanced by the taxpayers, affirmed Clark's calendar 1946

deficiency assessment, based on the accepted allocation to that year of \$22,113.56 (R. 92-93). Under the allocation of Clark's 70 per cent share of the fiscal 1947 constructive dividend, \$8,262.34 was attributable to the Clarks' calendar year 1947 income on a community property basis. (R. 110.) With respect to the \$4,463.76 excess of available fiscal 1947 earnings, as adjusted, over \$74,984.96, as computed by the agent, the Tax Court expressly held (R. 93-94) that, absent any affirmative pleading or evidence adduced by the Commissioner, no basis existed for carrying such excess over into the corporation's fiscal year 1948.⁹

In arriving at its adjusted fiscal 1947 distribution figure of \$79,448.72, the Tax Court recast, somewhat, the corporate gross income and distributable earnings figures computed by the agent (R A R, Schedule 1, p. 5; Ex. Q., p. 81). Additional gross income of \$138,473.43 (R A R, Ex. Q., p. 81), as computed by the agent, was reduced to \$97,511 by reason of the elimination therefrom of: (a) the Y. L. Creed item of \$3,058.50 (R. 102);¹⁰ (b) \$1,480.67,

⁹ Actually, although the determination is academic for purposes of this appeal, it is submitted that the axiomatic treatment of a corporation's excess earnings and profits accumulated over and beyond the dividend distribution of a given year would be to carry the excess over automatically to the following year as accumulated earnings and profits available for dividend distribution in the later year. In other words, the concept is a basic one, generic to the federal income tax law, and is not dependent for its operative effect on affirmative pleading or the introduction of evidence. Since, here, the corporation's fiscal 1948 earnings and profits, as determined by the Tax Court, were exhausted, with the finally determined deficiency being smaller than the assessment against the Clarks for their calendar year 1947, this \$4,463.76 excess from fiscal 1947 earnings and profits could presumably have been used had the Tax Court held otherwise. However, this issue has not been raised by the Commissioner and is not before this Court on appeal.

¹⁰ This item is discussed, *infra*, in Part B. Under its findings (R. 63-64), the Tax Court held (R. 102) that the credit of \$2,378.50 allowed Clark was income to Clark and his wife for calendar year 1946 (R. 91), with one-half thereof being attributable to Clark, individually. The amount, however, was in excess of the deficiency assessment and, accordingly, was not taken.

representing 10 per cent of fiscal 1947 substituted items (R. 96), allowed as a deduction because of the claimed cashing of accommodation checks (*Cohan v. Commissioner*, 39 F. 2d 540 (C.A. 2d)); (c) other investments of \$273.97 (R. 105-106), included by the agent but excluded by the trial court; and (d) "Notes Receivable—Officers" in the amount of \$36,149.29 (R. 102-105), included by the agent and held to be dividends but not included by the trial court (R. 105). To the \$97,511 was added \$30,632.10 (R. 59), representing reported fiscal 1947 income, which, apparently inadvertantly, had been omitted by the agent from his computation of distributable earnings. [In the Tax Court's computation of fiscal 1947 distributable earnings, \$63,488.47 (which the agent had included in income (RAR, Schedule 1, p. 5) but eliminated, erroneously, from distributable earnings (RAR, Ex. Q, p. 81)) was restored (R. 92).] From the resulting adjusted figure of \$128,-143.10 (which was thus identical both as income and as distributable earnings) a federal tax adjustment of \$48,-694.38 (R. 91) for accrued income taxes was deducted (*Estate of Stein v. Commissioner*, 25 T.C. 940), thus producing an adjusted distributable constructive dividend figure of \$79,448.72 for the corporation's fiscal year 1947, which, as indicated above, was greater than the agent's computation of \$74,984.96 (RAR, Ex. Q, p. 81), which was the basis for the deficiency assessment against Clark for his calendar year 1946. Accordingly, the taxpayers having demonstrably failed to carry their burden of proving error, the Tax Court, with more than ample justification, sustained the deficiency.

Before this Court taxpayers argue repetitively (Br. 17, 23-25) that the Tax Court should not have restored the \$63,488.47, referred to above, to distributable earnings of the corporation for its fiscal year 1947. There is clearly no merit in the contention. The \$63,488.47 is comprised of five items (R. 94-97)—*viz.*, Truman Johnson (\$6,000), H. L. Brittain (\$1,860.40), deferred sales income received in cash in fiscal 1947 (\$49,210.15), merchandise purchases deduction disallowed (\$2,714.42), and

bad debts deduction disallowed (\$3,703.50). All of these items were included by the agent in his total adjustments to gross income for fiscal 1947 (\$102,050.17, R. 91) which (as reduced to \$97,511 by the Tax Court's elimination of the Y. L. Creed item and the allowance of \$1,480.67 on account of the cashing of accommodation checks) is not contested. The amounts of each of the involved items are not and have never been in dispute. No affirmative evidence has been adduced by taxpayers to sustain their burden of proving error in the Commissioner's inclusion of these items in both fiscal 1947 income (which is not contested) and in distributable earnings for that year. Taxpayers' Witness Claypoole's testimony with respect to these items (R. 194-195) was not only inconclusive but vague, although he admitted that the deferred sales income might well have been represented by cash received. No affirmative value attaches to the testimony, however, since he admitted on cross-examination that he had not examined the books and records (R. 208) and had no knowledge of actual distributions (R. 211). He admitted further (R. 209-210), thus contradicting himself, that non-cash items can be distributed. Revenue Agent Phillips' testimony (R. 309-311) that he had reduced distributable earnings by these items was given in explanation of his adjustments made in Exhibit Q of his report, which, of course, is not in evidence for other than the limited purpose of showing the computation basis of the deficiency assessments. His testimony, accordingly, is in no way binding on either the Commissioner or the Tax Court. Moreover, as the Tax Court clearly pointed out (R. 94-97), the revenue agent's treatment of these items, distributable earnings-wise, was essentially based on the erroneous notion that to be distributable the item must be in cash. [Claypoole's admission to the contrary supports rather than refutes the Tax Court's treatment accorded all of these items.] Further, the fact that these items were all admitted income items, increasing the corporation's income for the year is proof, of itself, that they similarly increased

distributable earnings. Obviously, as the Tax Court pointed out (R. 95), there is no requirement that distributable income be in cash or in any particular tangible form or that it may be distributable only in the form in which it is earned. Essentially the determination herein made by the Tax Court with respect to includibility in earnings and profits is a legal determination, altogether properly within the province of the trial judge for determination. We are in complete accord with the specific reasons given by the Tax Court below (R. 94-97) for restoring each of these admitted fiscal 1947 income items to distributable earnings for the year and we adopt that reasoning as our own.

With respect to both Gene and Faye Clark's calendar year 1947, the Commissioner assessed deficiencies (R. 14, 34) based on each spouse's receipt of \$24,750.49 derived equally from Gene Clark, Inc.'s constructive dividend of \$49,500.99 for its fiscal year 1948. After adjustment for rectifiable errors in the agent's computation of this \$49,500.99 (\$43,376.22 plus \$8,262.34 less \$2,137.57 for a partial liquidating dividend charge to surplus) (RAR, Ex. Q, p. 81), the Tax Court determined deficiencies in a lesser amount, based on adjusted constructive dividends from the corporation in the total amount of \$39,782.58 (R. 151, 156).

As a computation basis for the assessed deficiencies, the revenue agent computed a total distribution of \$149,233.83 (RAR, Ex. Q, p. 81), which was predicated on (a) adjustments to net income by reason of unreported sales, substituted items (\$35,419.36) and other uncontested adjustments, which altogether totaled \$92,208.62; (b) four items totaling \$63,406.36; and (c) a deduction of \$6,381.15 for two items treated by the agent as non-available. All of the items included in the \$92,208.62 were stipulated or uncontested with the exception of one substituted item (Pacific Pumps, Inc.) of \$1,094.52 (R. 115), which the agent had included in error. The Tax Court made adjustment for this item, which reduced substituted items to \$34,324.84 and then made an additional allowance of

\$3,432.48 (R. 117) to the reduced sub-total on account of the cashing of accommodation checks (*Cohan v. Commissioner, supra*), the two adjustments serving to reduce the \$92,208.62 adjustment to net income to \$87,681.62 (R. 119). For reasons detailed in its opinion and not here opposed (R. 119-121), the Tax Court eliminated the four items, totaling \$63,406.36, which we have referred to, *supra*. The two items deducted in the combined amount of \$6,381.15 were held by the Tax Court (R. 119-120) to have been eliminated by the agent in error. The trial judge concluded (R. 120): "We think both are includible in available earnings for fiscal 1948 * * *." However, in computing adjusted available earnings, the Tax Court apparently inadvertently omitted these two "includible" items and arrived at a figure of \$104,408.02 (R. 119), which represented the sum of the reduced net income adjustments of \$87,681.62, mentioned above, and \$16,726.40 (R. 59) the reported income on the fiscal 1947 tax return, which, inadvertently, the agent had omitted from his Exhibit Q computations (RAR, Ex. Q, p. 81). From this \$104,408.02 the Tax Court deducted (R. 121-122) accrued fiscal 1948 federal income tax (\$39,399.42) and Section 293(b) additions to tax for fiscal 1947 (\$19,979.69) (*Estate of Stein v. Commissioner, supra*; *Stern Brothers & Co. v. Commissioner*, 16 T.C. 295), totaling \$59,379.11, thus arriving at distributable earnings for fiscal 1948, in the amount of \$45,028.91 (R. 122).

The Tax Court next computed (R. 122) actual distributions for fiscal 1948 by deducting the elimination items totaling \$63,406.36 (uncontested) from the agent's computed total distribution figure of \$149,233.83 (also uncontested) to arrive at a net amount of \$85,827.47. The trial judge then pointed out (R. 122-123) that while accrued federal taxes and prior year Section 293(b) civil fraud penalties are properly deductible from adjusted net income for purposes of determining distributable earnings (*viz.*, \$45,028.91, *supra*) actual distributions are computed without the tax and fraud penalty accrual de-

duction "because actual distributions may, and often do, exceed available earnings, the excess being in the nature of liquidating dividends" (R. 123).

It is to be observed that all of the foregoing adjustments, with the possible exception of the elimination of the Pacific Pumps item and the *Cohan* rule allowance for accommodation checks were properly made at the Tax Court's initiative by way of correcting obvious omissions and apparent errors in the revenue agent's computation of the fiscal 1948 constructive dividends. The Tax Court expressly pointed out, however (R. 123), that apart from these adjustments "petitioner has failed to meet the burden of proving error in respondent's determination." Accepting the actual total distribution figure of \$85,827.47, as computed above, the Tax Court first applied against this amount the \$45,028.91, representing earnings available for distribution as ordinary dividends. The balance of \$40,798.56, not being covered by earnings and profits, is, of course, properly to be treated as a liquidating dividend. *Drybrough v. Commissioner*, 238 F. 2d 735 (C.A. 6th), affirming in part and reversing on another issue *United Mercantile Agencies, Inc. v. Commissioner*, 23 T.C. 1105. However, since the value of Clark's stock was stipulated by the parties to be \$61,214.49 (R. 82, 133) and the 70 per cent of this liquidating dividend allocable to Clark—*viz.*, \$28,558.99 (R. 123)—did not equal the stock's basis, the Tax Court correctly held that the additional liquidating distribution of \$40,789.56 was not material to either spouse's individual tax liability for calendar year 1948.

Under the Tax Court's reconstruction of the adjusted corporate constructive dividend of \$45,028.91 for fiscal year 1948, Clark's 70 per cent share was \$31,520.24 (R. 123-124), which, dollar-wise, was substantially lower than the agent's allocation of \$41,238.65 to Clark (RAR, Ex. Q, p. 81), the fiscal 1948 constructive dividend which together with the \$8,262.34 (R. 110) allocated from fiscal year 1946, formed the basis for the deficiencies (\$49,-

500.99) assessed against the Clarks, community property-wise, for their calendar years, 1947. Since the total distribution for fiscal year 1948 amounted to \$85,827.47 and the distributable earnings, which must be taken off first in determining taxable ordinary dividends, amounted to \$45,028.91 (of which \$31,520.24 was attributable to Clark), the Tax Court had ample basis for holding, absent taxpayers' adducement of any affirmative proof to the contrary, that (R. 124):

On any appropriate basis of allocation of distributions (\$85,827.47) from fiscal 1948 to calendar 1947 (which included eight months of fiscal 1948), the distributions attributable to calendar 1947 would be at least sufficient to encompass total ordinary dividends including the \$31,520.24 attributable to Clark.

There is no merit in taxpayers' contention (Br. 9-10, 25-26, Exs. E and F, Appendix 5-9) that the allocation of Clark's entire share of the fiscal 1948 constructive dividend to the Clarks individual calendar year 1947 was anything other than reasonable. As the Tax Court pointed out (R. 123-124) the principle of federal tax law is axiomatic that when total distributions (\$85,827.47) represent both distributable earnings and a partial return of capital, the distribution must *first* be applied against the available earnings and profits (\$45,028.91) for distribution as ordinary dividends. *Drybrough v. Commissioner, supra*. Accordingly, any reasonable basis of allocation, here, would have to attribute both the entire \$45,028.91 and some additional portion of the remaining liquidating dividend (\$40,798.56) to calendar year 1947 were it not for the fact that Clark's stock basis was so high that no additional portion of the \$40,798.56 could here be treated as calendar 1947 ordinary income. Again, the self-contradictory admission by the taxpayers' own witness, Claypoole (R. 207), that year-end earnings and profits determine the ordinary dividend treatment to be accorded prior distributions, amounts to tacit agreement with the basic federal tax principle here involved.

Further, taxpayers so-called Exhibits "E" and "F" (Appendix 5-9), which they admit [at least as to Exhibit "E" (Br. 32)] "are not based upon the evidence in this case," amount to nothing more than self-serving computations based, in many respects, on arithmetical distortions of various figures picked at random from the different schedules and exhibits in the revenue agent's report.¹¹ Next, as a simple matter of arithmetic, it is observable that, on a straight line allocation between calendar years 1947 and 1948, by months, the \$31,520.24 allocated to the Clarks from the \$60,079.23 portion of the total distribution (\$85,827.47), representing his 70 per cent share of the fiscal 1948 distribution, is considerably less than the \$39,949.56, which represents 66 2/3 per cent of Clark's fiscal 1948 share attributable to calendar year 1947, eight months of which were included in such fiscal year. Finally, the fact remains that taxpayers have failed utterly to carry their burden of proving error in the reduced calendar 1947 deficiencies, as adjusted downward by the Tax Court.

B. *The Tax Court did not err in finding and concluding that the Commissioner had sustained his burden of proving fraud*

Section 293(b) of the Internal Revenue Code of 1939 (Appendix, *infra*), provides that "If any part of any deficiency is due to fraud with intent to evade tax" then 50% of the deficiency shall be added thereto. It has

¹¹ For example, the \$5,080.40 fiscal 1948 deferred income item, which the Tax Court, possibly inadvertently, left out of account altogether in reconstructing total fiscal 1948 distributions, is included by taxpayers in their Exhibit "F" summary (Appendix 9) not once but twice. Included in such summary is a \$39,300.87 item for "Unreported Income * * * in Other Bank Accounts" which did not enter into the Tax Court's consideration at all and is accordingly irrelevant, except as evidence of Clark's disposition of appropriated cash. In Exhibit "E" taxpayers include in their computation of earnings and profits \$63,488.47 which was not even treated by the Tax Court as a figure applicable to that fiscal year.

been held that these plain words leave no room for construction. *Mauch v. Commissioner*, 113 F. 2d 555 (C.A. 3d).

The Tax Court found (R. 83):

Each of the returns of Gene Clark for the years 1946 and 1947 was false and fraudulent with intent to evade tax within the meaning of section 276(a) of the Internal Revenue Code of 1939. A part of the deficiency of Gene Clark for each of the years 1946 and 1947 was due to fraud with intent to evade tax within the meaning of section 293(b).

The Tax Court concluded (R. 134-137), on the basis of an examination of the entire record, with such scrutiny not being limited to a consideration of the Commissioner's affirmative evidence (R. 134), that Gene Clark's "intent to defraud is abundantly established" (R. 136). Specifically, the Tax Court concluded with respect to the 1946 deficiency (R. 137-140) that, on the basis of the entire record (R. 137-138) and on the basis of at least two selected specific transactions (R. 138-140), at least a part of the deficiency for calendar year 1946 was due to fraud with intent to evade tax. He reached the identical conclusion (R. 140-142) with respect to Clark's calendar 1947 deficiency, on the basis of both the over-all record and, specifically, on the basis of three selected transactions.

It remains to consider the applicable legal principles and the proof.

The burden of proof of fraud, as the Tax Court observed (R. 134), rests upon the Commissioner. Section 7454(a) of the Internal Revenue Code of 1954. It is well settled that whether an understatement of income is due to fraud presents solely a question of fact, and that the Tax Court's determination in respect thereof is final if supported by clear and convincing evidence and is not shown to be clearly erroneous. *Helvering v. Kehoe*, 309 U. S. 277, 279; *Carmack v. Commissioner*, 183 F. 2d 1 (C.A. 5th), certiorari denied, 340 U. S. 875; *Davis v.*

Commissioner, 239 F. 2d 187 (C.A. 7th), certiorari denied, 353 U. S. 984; *Bodoglau v. Commissioner*, 230 F. 2d 336 (C.A. 7th); *Halle v. Commissioner*, 175 F. 2d 500, 503-504 (C.A. 2d), certiorari denied, 338 U. S. 949; *United States v. Gypsum Co.*, 333 U. S. 364, 394-395, rehearing denied, 333 U. S. 869; Rule 52(a), Federal Rules of Civil Procedure.

In proving fraudulent intent the Commissioner has to show only that some part of each deficiency was due to fraud with intent to evade tax. Section 293(b) of the 1939 Code, *supra*. While "Fraud is not to be lightly inferred, but must be established by clear and convincing proof" (*Rogers v. Commissioner*, 111 F. 2d 987, 989 (C.A. 6th)), yet the obligation of the Commissioner to prove it relates only to the fraud penalty and not the correctness of the deficiency (*Cohen v. Commissioner*, 9 T.C. 1156, affirmed, 176 F. 2d 394 (C.A. 10th); *United States v. Chapman*, 168 F. 2d 997 (C.A. 7th), certiorari denied, 335 U. S. 853). Moreover, "there is no burden upon the Government to prove its case beyond a reasonable doubt". *Helvering v. Mitchell*, 303 U. S. 391, 403; *Spies v. United States*, 317 U. S. 492, 495.

Bearing these well established legal principles as to burden and proof in mind, the Tax Court concluded, under the entire record here before the Court, that (R. 135) "the intent to defraud is established beyond question." As clear and convincing proof of such conclusion, drawn from the entire record, the Tax Court then detailed the following "badges of fraud", which pervade the entire record (R. 135-136):

(a) Substantial (though undetermined) amounts of receipts from sales made by Gene Clark, Inc., were neither recorded on its books nor reported on its income tax returns. [See testimony of Government witnesses, affirmatively adduced: Y. L. Creed (R. 213-219); Truman Johnson (R. 220-226); Ben Lang (R. 227-229); Frances B. Bittinger (R. 229-232); and of Lloyd George Meissenburg (R. 232-240) as to particular transactions they or

their customer firms had with Gene Clark, Inc. See, further, the testimony of Government Witness Files (R. 240-287) affirmatively adduced to show the control asserted by Clark over books and records throughout the 1946-1947 fiscal years, particularly with respect to handling cash (R. 244-248); the practice of not recording certain sales and the substituted check practice consistently followed incident thereto (R. 249-251); the withholding of certain sales invoices (R. 257-258); the purchase of the Kansas farms with corporate funds (R. 271-274); the retention by Clark of the corporation's only declared cash dividend notwithstanding an offsetting debit to "Notes Receivable—Officers," covered by substituted checks (R. 281-282), etc. [See particularly the testimony of Revenue Agent Phillips (R. 287-315), during the course of which (R. 290-305), the taxpayers' counsel stipulated to the fact that virtually all of the contested sales transaction items added to fiscal 1947 and 1948 net income by the agent were either unrecorded and unreported and/or substituted check transactions.]

(b) Substantial amounts of cash passed to Clark personally. [See the third-party customers' testimony, *supra*, as to transactions giving rise to Clark's receipt of sales proceeds which were neither recorded or reported. See Files' testimony as to Clark's receipt of \$12,000 cash from Valley Boulevard Plumbing & Electric Company (R. 254-255).]

(c) Clark's express admission (R. 366) that, being in control, it was his own idea not to record certain sales as a means of withholding cash from the corporation and that he directly participated in such diversions. [See Clark's numerous admissions as to profits on unreported over-ceiling sales of materials (R. 362-363); his failure to account for profits (R. 367); his practice of taking personal charge of cash (R. 374); his receipt of \$12,000 cash from Meissenburg (R. 336-337); his receipt of other Meissenburg monies (R. 342); etc.]

(d) Clark's instructions to his comptroller, Files, to have certain cash receipts from sales set aside, with

the transaction being unrecorded and the proceeds being turned over personally to him. (R. 374.)

(e) Clark's substituted check practice, consistently followed throughout the period—*viz.*, recorded but undeposited sales being covered by depositing substituted third party customer checks received incident to unrecorded sales transactions—with the withheld cash going to Clark personally. [See Clark's express admissions (R. 364-368), coupled with this counsel's stipulations, during the course of Revenue Agent Phillips' testimony (R. 287-305) as to the fact of substitution; specifically, for example, in the case of the three Hamilton Homes, Inc., substituted checks (R. 296-297, etc.)]

(f) Clark personally sold plumbing materials from the El Monte (main) office without accounting for or recording the proceeds on the books of the company. [See testimony of Government Witness Files that: No records were kept of cash withheld by Clark (R. 245); he knew inventory was removed from stock at El Monte shop which was unrecorded (R. 246); such unrecorded sale of materials was a regular recurrence (R. 249-250); the corporation's initial inventory was taken over from Gene Clark Plumbing and purported to be the entire inventory (R. 260-262); and no books were kept for Gene Clark Plumbing (R. 257-258). Further, see admissions of Clark that: No records were kept on sale of materials (R. 331-332); he took the Gene Clark Plumbing inventory at time of incorporation himself (R. 356); such inventory record was no longer available (R. 324-325); he received cash from the sale of materials (R. 331); the \$12,000 cash received from Meissenburg was undeposited (R. 338); and inventory trading transactions were unrecorded (R. 333-334).]

(g) Clark engaged in over-ceiling sales without accounting for all the proceeds or profits therefrom. [See Clark's admissions that the practice continued throughout the period at a profit (R. 361-362); also, that the corporation never reported this profit (R. 363).]

(h) Neither Gene Clark, Inc., nor Gene Clark reported the proceeds from over-ceiling material sales on their tax returns. [See Clark's admissions to this express effect. (R. 362-363, 364.)]

Summarizing the foregoing "badges of fraud" (R. 135-136), the Tax Court stated its opinion (R. 136) that Clark's alleged explanations for his use of the substantial amounts of cash admittedly received—*viz.*, that he needed it for the purpose of plumbing materials at over-ceiling prices—was unworthy of belief. As developed above, he had no inventory records of the materials on hand when the corporation was formed (R. 331-332, 324-325) and he had no available record of the amounts he claimed to have spent for over-ceiling priced materials (R. 330). His bookkeeper, Files, testified (R. 268) that no records were kept of trading transactions in materials. The taxpayers' witness, Claypoole, admitted (R. 208) he had never examined the books and records of the corporation. Finally, whereas Clark testified (R. 328-329) he made extensive purchases at over-ceiling prices from a Mike Harvey at Tyler Foundries; in Texas, Harvey was not called as a witness to corroborate such testimony. Under these circumstances, due consideration should properly be accorded the Tax Court's opportunity to see and judge the credibility of the witnesses. *Quock Ting v. United States*, 140 U. S. 417; *Davis v. Commissioner*, 239 F. 2d 187, 190 (C.A. 7th), certiorari denied, 353 U. S. 984; *Bryan v. Commissioner*, 209 F. 2d 822 (C.A. 5th), certiorari denied, 348 U. S. 912; *Boyet v. Commissioner*, 204 F. 2d 205 (C.A. 5th).

With specific reference to Clark's calendar year 1946 (R. 137-140), the Tax Court pointed to the evidence of Files (R. 137), detailed above, with respect to Clark's unrecorded and unreported sales and diversions of corporate funds in substantial but not precisely calculable amounts as giving rise to the reference of fraud. Further, he pointed out that since the corporation reported income for the fiscal 1947 year, indicating earnings avail-

able for distribution, there can here be no doubt (R. 137) that the diversions during the last eight months of the calendar year 1946 represented, at least in part, constructive dividends to Clark which were not included in the separate calendar 1946 returns filed by himself and his wife.

This circumstantial evidence of fraud while altogether clear and convincing is buttressed substantially by Clark's express admissions with respect to his control over and receipt of cash from unrecorded and unreported transactions as well as by the admitted failure to keep adequate books and records. Indeed, it would be difficult to marshal more clear and convincing proof of an affirmative nature in support of the Commissioner's burden to prove a part, at least of the 1946 deficiency was due to fraud with intent to evade tax.

However, the Tax Court proceeds (R. 138-140) to present an analysis of the pre-incorporation Y. L. Creed transaction and the Truman Johnson transaction whereby plumbing contract work performed by Gene Clark, Inc., was intentionally arranged between the parties in such a manner that the agreed price and the amount deposited failed to reflect the true nature of the transactions. In the Creed transaction, Clark performed plumbing work for which Creed agreed to pay \$2,922.50. Before incorporation of Gene Clark, Inc., Creed paid \$544 which was deposited to the account of Gene Clark Plumbing. Later, in June 1946, after incorporation, Creed credited Clark personally with the balance of \$2,378.50 on his purchase of one of Creed's houses. The credit was never reported by either Clark, individually, or in the corporation's fiscal 1947 return. (R. 302.) Since earnings and profits existed in the corporation to more than cover the item, and since, alternatively, the item, as credited, would otherwise be income to Clark, individually, in calendar year 1946, it becomes obvious that some part of Clark's calendar year 1946 deficiency was due to the omission to report. Before the Tax Court, Creed was called as a

government witness (R. 213-218) and testified (R. 218) that the balance of \$2,378.50 was credited to Clark on his purchase from Creed of a \$8,500 house, as of June 13, 1946 (R. 215). The Truman Johnson transaction (R. 139-140) consisted of an October 5, 1946, corporation contract to supply plumbing materials and services on ten houses Johnson was building, at an agreed price of \$9,300. At Clark's request (R. 223) and over Government Witness Johnson's objection (R. 226), the price was set in the written contract at \$3,300 (instead of \$9,300, the actual price). The difference of \$6,000 was credited by Johnson to Gene Clark, Inc., on a house which the corporation purchased from Johnson in 1946. (R. 223.) (The house was sold by the corporation to Clark in 1947.) Johnson's books recorded the full cost of the materials and services, furnished, including the \$6,000. (R. 224.) The \$6,000 was neither recorded on the corporation's books nor reported on its income tax returns.

With respect to the clear import of these specific transactions, the Tax Court, we submit correctly, stated (R. 139-140):

Here Clark's intention to defraud was deliberate and obvious. While in the first instance, the fraud from the income tax standpoint affected the tax of the corporation, it likewise had its effect upon the income and tax of Clark arising out of diversions from the corporation by Clark, which, to the extent of the actual diversions, and not to exceed available earnings, are to be treated as ordinary dividends. Whether or not Clark was familiar with all of the income tax accounting factors involved is not material. His intent was to defraud, both as to himself and the corporation, and he succeeded.

Accordingly (R. 140), the Tax Court held that Clark's calendar 1946 tax return was false and fraudulent with the obvious intent to evade taxes and that some part of his calendar 1946 deficiency was due to fraud with intent to evade taxes, within the meaning of Section 293(b) of the 1939 Code.

With specific reference to Clark's calendar year 1947 (R. 140-142), the Tax Court first pointed out that the same pattern of unrecorded corporate sales, with diversion of corporate funds to Clark, who, in turn, failed to report such receipts, prevailed during calendar year 1947, as was the case in 1946.

With respect to specific instances of fraud, the Tax Court selected the three payments (totaling \$5,686) from Hamilton Homes, Inc. (R. 140-141), the \$1,000 H. K. Niles transaction (R. 141), and the \$2,731.54 Valley Cities Supply Company transaction (R. 141) as clear examples. During the course of Government Witness Frances B. Bittinger's testimony, the taxpayers' counsel stipulated (R. 230) that the three Hamilton Homes checks were issued to Gene Clark, Inc., in payment of sales invoices. During the course of Revenue Agent Phillips' testimony, the taxpayers' counsel stipulated (R. 296-297) that all three Hamilton Homes checks, issued in July and September, 1947, were not recorded on the corporations books or reported on either the corporation's or the taxpayer's tax returns. Similar stipulations were entered into with respect to the H. R. Niles checks (R. 297) and the Valley Cities Supply Company (R. 295). Taxpayers' further stipulated (R. 297) that these items were deposited by Gene Clark, Inc. On the basis of such agreed facts, the Tax Court pointed out (R. 140-141) that such deposits necessarily substituted these checks, arising out of unrecorded and unreported transactions, for undeposited payments from other customers on recorded transactions. As the trial court pointed out (R. 141) while Clark did not expressly concede these particular substitutions, he admitted (R. 365-367): That he understood the substitution practice; that it was his idea; that substitutions were made; that the proceeds or profits were not accounted for; and that the practice was continued throughout the period (R. 393). Accordingly, since the sales per books, per returns, and the bank deposits reconciled (as to totals) with each other (R. 463-464), the Tax Court pointed out

(R. 141), we submit correctly, that the only possible inference or explanation is that substitutions of checks (received for unrecorded sales) for previously undeposited and diverted proceeds of recorded sales were made. Accordingly, the Tax Court concluded (R. 141):

That at least a substantial part of the undeposited amounts went to Clark is obvious * * *. Here again, it is not significant on the fraud issue to place a label on the diversions. There were ample earnings of the company available for distribution as ordinary dividends. Thus, whether we treat the diversions as ordinary dividends or direct income to Clark, the result is the same. The income was not reported by Clark or his wife.

Accordingly (R. 142), the Tax Court held that the income tax return of Gene Clark for calendar year 1947 was false and fraudulent, with intent to evade taxes, and that part of his deficiency for 1947 was due to fraud with intent to evade taxes.

It remains to observe that there is nothing of merit in the taxpayers' contention (Br. 28-31) which should here be viewed as disturbing the Tax Court's findings and conclusions with respect to Clark's liability for the assessed additions to tax under Section 293(b) for his calendar years 1946 and 1947, to the extent here in issue. Under the entire record, embracing both the Commissioner's compelling affirmative proof adduced and the taxpayer's fatally damaging admissions, both on the stand and by stipulation, it would be difficult to hypothesize a case wherein the Commissioner might more clearly and convincingly sustain his burden of proving fraud, within the meaning of the statute.

C. Section 275(c) is no bar to the assessment and collection of the deficiencies

We have shown in A and B, above, that the taxpayers have failed to sustain their burden of proving error in the deficiencies, as assessed against Gene Clark for his

calendar year 1946, and as assessed, and adjusted, with respect to both spouses' calendar years 1947, and, also, that the Commissioner has sustained his burden of proving, by clear and convincing evidence, that at least part of the deficiencies assessed against Gene for his calendar years 1946 and 1947 was due to fraud with intent to evade tax, within the meaning of Section 293(b) of the Internal Revenue Code of 1939. It remains to point out that, in view of the fact that the taxpayers each omitted properly includible amounts from gross income in his and her calendar 1947 returns, which were in excess of 25 per centum of the amounts of gross income stated in such returns, that the five year statute of limitations provided for in Section 275(c) of the 1939 Code (Appendix, *infra*) is no bar to the assessment and collection of the two calendar 1947 deficiencies.

With respect to Gene Clark, it must be observed that his filing of false and fraudulent returns for calendar years 1946 and 1947, as demonstrated above, in and of itself tolls any statute of limitations bar to the assessment and collection of his deficiencies. However, since both spouses filed separate calendar 1947 returns, on a community property basis, on March 15, 1948 (R. 20, 40), and since their 1947 deficiencies were both assessed on February 20, 1953 (R. 10, 30), with the finally determined additional 1947 gross income here in issue being attributed to each on a community property basis, the reasons here advanced in support of the validity of Faye's adjusted deficiency would apply with equal force to Gene's, were it not for the fact that the fraud attaching to his calendar 1947 return keeps the year open, in any event.

Under the facts, it is altogether clear that Section 275(c) is no bar to either spouse's 1947 deficiency. On March 15, 1948, both spouses filed their calendar 1947 returns, with each reporting gross income of \$9,130.51. (R. 18, 38.) The statutory notice of deficiency was transmitted to each, on February 20, 1953 (R. 10, 30), more than three but less than five years after the returns were

filed. No waivers were filed. As a matter of arithmetic, 25 per centum of the \$9,130.51 reported by each spouse on the 1947 return is \$2,282.63. Since the applicability of Section 275(c) was raised by the Commissioner in the answer (R. 20, 40), the burden of proof is on him. He need not, however, establish a precise amount so long as it is apparent from the affirmative evidence that at least \$2,282.63 (25 per cent of the reported calendar 1947 gross income, per the return) was omitted.

We submit that the Tax Court was entirely correct in holding (R. 143) that the Commissioner altogether clearly met his burden of proving the omission of at least \$2,282.63 from both spouses' calendar 1947 returns, as filed. The arithmetical demonstration is quite simple and has been set forth in Part B above, in showing that the Commissioner adduced affirmative proof, on the specific calendar 1947 fraud issue that Gene Clark, Inc., understated its gross income by \$9,417.54, by failing to record or report its receipt of the five substituted checks from Hamilton Houses, Inc. (three checks totaling \$5,686), H. K. Niles (\$1,000), and Valley Cities Supply Company (\$2,731.54). As has been shown above, 70 per cent of this total amount—*viz.*, \$6,592.28—constituted gross income diverted from the corporation by Clark to be accounted for on the elected community property basis in their separate returns for 1947. Again for the reasons stated with respect to the fraud issue, it is a distinction without a difference as to whether the items be deemed direct income to Clark and his wife or constructive dividends. They represent gross income in either event, and one-half of Clark's share of each was includible, on the community property basis, in gross income on Faye's individual return for 1947. The amount so omitted from gross income on her return which should have been included therein—*viz.*, \$3,296.14—was well in excess of \$2,282.63, and the statute of limitations, therefore, is not a bar to assessment as to Faye Clark for 1947, or, for that matter, as to Gene, absent the fraud attaching to

his return, which, of course, frees the assessment and collection from the statute altogether. The question of intent on the part of Faye is no way material to this issue.

Finally, it may be observed that there is no merit in the taxpayers' contention (Br. 32-33) to the contrary. We have already demonstrated in Part B, *supra*, the fallacious self-serving conclusions they allege in their Exhibits "D" and "E" which as they themselves admit (Br. 32) do not stand as record evidence. They have adduced no proof whatsoever to refute the affirmative evidence adduced by the Commissioner, which was far more than enough to sustain his burden of proving at least the required \$2,282.63 omission from gross income reported by both spouses in their 1947 returns.

CONCLUSION

The decisions of the Tax Court should be affirmed.

Respectfully submitted,

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OCTOBER, 1958.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition*.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend*.—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

* * * *

(b) *Source of Distributions*.—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

* * * *

(d) [As amended by Section 214(b) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Other Distributions from Capital*.—If any distribution made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913,

and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. This subsection shall not apply to a distribution in partial or complete liquidation or to a distribution which, under subsection (f) (1), is not treated as a dividend, whether or not otherwise a dividend.

* * * *

(26 U.S.C. 1952 ed., Sec. 115.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

* * * *

(c) *Omission From Gross Income*.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

* * * *

(26 U.S.C. 1952 ed., Sec. 275.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * *

(b) *Fraud*.—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612 (d) (2).

(26 U.S.C. 1952 ed., Sec. 293.)

No. 16010

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GENE O. CLARK and FAYE CLARK,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of the Decision of the Tax Court of
the United States.

REPLY BRIEF FOR PETITIONERS.

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TOPICAL INDEX

	PAGE
Statement	1
Argument.....	2
A. The Tax Court did err in its determination of the de- ficiencies	2
Appellate review of findings of Tax Court.....	9
B. The Tax Court erred in finding and concluding that the Commissioner had sustained his burden of proving fraud	10
C. Section 275(c) bars the assessment and collection of any deficiencies	10
Conclusion	11

TABLE OF AUTHORITIES CITED

CASES

PAGE

Curtis Company v. Commissioner, 232 F. 2d 167.....	9
Gasper v. Commissioner, 225 F. 2d 284.....	11
Gillette's Estate v. Commissioner, 182 F. 2d 1010.....	9
Raymond Pearson Motor Company, et al. v. Commissioner, 246 F. 2d 509.....	9

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Statement.

In our Opening Brief for the Petitioners, we believe we presented a concise and fairly articulate presentation of the case now on appeal. In contrast, the Respondent chose to ramble roughshod over the matters in dispute, ignoring in many instances some of the major contentions of the Petitioners. Because of Respondent's approach to this case, it now becomes necessary to pinpoint the untenable position which he has taken.

ARGUMENT.

A. The Tax Court Did Err in Its Determination of the Deficiencies.

The correctness of the Tax Court's conclusions is not supported by the record. The theory of the Commissioner which was adopted by the lower Court is clearly enunciated in Respondent's Brief (p. 46) wherein it is stated in all seriousness.

“* * * it is pertinent to point out that it is the establishment of the availability of the constructive dividends to the taxpayer's use which is controlling with respect to taxability as income rather than the traceability of the diverted corporate funds into the taxpayers' respective pockets.”

This contention points up the major error committed, not only by the Respondent but also by the lower Court. Merely because a corporation had earnings and profits available for distribution does not mean that such earnings were actually distributed. If the Respondent's proposition is correct, then every stockholder of a corporation could be taxable individually at any time the corporation has earnings and profits.

In the instant case, actual distributions were never shown to have taken place. Gene Clark testified that the fruits of his transactions ended up in the corporation [R. 330, 332, 393]. Also see testimony of Frederick Files [R. 266-268]. If the corporation did not report these profits, it does not mean the profits are attributable to the Petitioners.

If the Respondent believes that earnings and profits of a corporation are taxable to its stockholders whether they are distributed or not, it is no wonder that he says, “In

such a case, the effect of the receipt on the net worth of the stockholder is patently irrelevant" (Resp. Br. p. 37).

The Petitioners agree that distributed earnings may be in the form of machinery, equipment, trucks, buildings and land, or other property, and that if such property is distributed to the stockholders of a corporation, they would be considered dividends to the extent of the earnings and profits in the corporation. But the fact is, that there was not a distribution of such properties. They remained in the corporation and are reflected in its balance sheets during the period here involved [see Exs. A, B and C in the Appendix to Pet. Op. Br.].

The agent recognized this when he designated certain items as not being available for distribution in his Revenue Agent's Report, which was the basis of the deficiency notice. Respondent blandly asserts this so-called "reasonably effective method for determining income (Resp. Br. p. 36) can also be used to tax earnings and profits of the corporation to the Petitioners, which the deficiency notice manifested were not distributed to them, by the mere use of arithmetic after the trial is over (Resp. Br. pp. 43, 45).

It should be obvious that if the Respondent takes a new position that further earnings of the corporation were distributed to Petitioners, the burden is upon him to prove it by evidence, and not by calculations based upon an arbitrary theory.

The Respondent has made no attempt to defend Petitioners' attack upon the Tax Court's changing of the agent's allocation of distributions except to reiterate the opinion of the lower Court and state that he agrees with it. Respondent first says the controlling factor here is the establishment of available earnings and profits (Resp. Br.

p. 46) and that the traceability of such earnings to the taxpayers is not important. He maintains that based upon this theory, we must accept as a fact that there were *actual* distributions and concludes he may now abandon his own theory of allocation of these undistributed earnings to the calendar years of the Petitioners because *actual* distributions must first be applied against available earnings and profits (Resp. Br. pp. 52, 53).

The documentary evidence introduced by Respondent himself does not even support his position or that of the Tax Court [R. 124] that

“On any appropriate basis of allocation of distributions (\$85,827.47) from fiscal 1948 to calendar 1947 (which included eight months of fiscal 1948), the distributions attributable to calendar 1947 would be at least sufficient to encompass total ordinary dividends including the \$31,520.24 attributable to Clark.”

The only evidence in the record tending to show there were transactions of Gene Clark, Inc., which were not reported on its returns are the following checks:

<u>Exhibit</u>	<u>Date</u>	<u>Amount</u>
S	April 21, 1948	\$ 1,558.44
Y	February 12, 1948	1,700.00
AA	September 20, 1947	2,731.54
CC	January 9, 1948	2,294.50
LL	January 29, 1948	3,074.74
MM	February 9, 1948	22,935.00
BBB	March, 1948	12,000.00
TT	February 10, 1948	2,223.76
UU	January 24, 1948	1,902.73
TOTAL		<u><u>\$50,420.71</u></u>

It should be noted that Exhibit AA bears the endorsement of Archie Koyl, indicating he was the recipient of this check.

Exhibits U, V, W, X and DD, totaling \$13,580.00, were also introduced into evidence but all of these checks were deposited in Gene Clark, Inc.'s bank account and reported by the corporation on its return.

The total of the aforementioned exhibits equals \$64,000.71 of alleged unreported income. Aside from this, the record is devoid of any evidence as to the remainder of the amount which Respondent asserted to be earnings and profits available and distributed to the stockholders of Gene Clark, Inc.

Even assuming the entire \$64,000.71 was unreported income of the corporation, it does not automatically follow that Petitioners were the recipients of any of it, because, as has been repeatedly stated, there was no evidence to contradict Gene Clark's testimony that all of the profits of his transactions ended up in the corporation.

It must be observed that the vast majority of the exhibits introduced reveal transactions occurring in the calendar year 1948 and not in 1946 or 1947. How can a transaction which occurred in the calendar year 1948 be taxed to Petitioners in 1947?

The Respondent's own evidence does not support a finding that \$45,028.91 was distributed to the stockholders of Gene Clark, Inc., in their calendar year 1947, or that \$31,520.24 of such amount should be attributable to Petitioners.

The Respondent now recognizes that accrued taxes and penalties should be deducted from the net income of Gene Clark, Inc., to arrive at earnings and profits available for

distribution, but is silent as to the accrual of interest (Resp. Br. p. 51). It is presumed, therefore, he agrees that the Tax Court erred in not accruing the interest on such tax and assessed penalty.

Although the accrual of such items is conceded, they were not in fact taken into consideration when the lower Court determined the amount of distributions to the petitioners in their calendar year 1947 [R. 123].

Using the Tax Court's figures [R. 122], the total net income of Gene Clark, Inc., for fiscal 1948 was \$104,408.02. From this amount, \$39,399.42 of accrued taxes and \$19,979.69 of accrued penalties were deducted, leaving \$45,028.91 of earnings available for distribution. If we now deduct accrued interest on such taxes and penalties in the amount of \$2,963.99, we have a balance of \$42,064.92 available for distribution. At this point, the lower Court, without any basis or known reason, varied from the Respondent's determination. The Commissioner attributed 41.523 per cent of available earnings and profits of Gene Clark, Inc., for fiscal 1948 to its stockholder's calendar year 1947. The Tax Court applied 100 per cent of the available earnings and profits of the corporation's fiscal year 1948 to its stockholders.

If the lower Court had followed Respondent's theory, only \$17,466.62 (41.523% of \$42,064.92) would have been attributable to the stockholder's calendar year 1947. Of this amount, 70 per cent was attributed to Petitioners, making a total distribution to them of only \$12,226.63.

The proper approach to the problem, with correct computations, has been set forth in Petitioners' Opening Brief [pp. 23-26, incl., and Exs. D and E of the Appendix]. The result reached above, aside from other errors, does

not take into account the deductibility of \$77,207.15 of asserted 1948 transactions [Ex. F of Appendix to Pet. Op. Br.] or the \$20,000.00 dividend paid to Gene Clark, from earnings and profits available for distribution in 1947.

It must be made clear that contrary to Respondent's assertion (Resp. Br. p. 42), Petitioners have always contested the entire deficiency set up against them for each year involved. Petitioners did stipulate certain transactions were not reported by the corporation or the Petitioners on their returns. This does *not* mean Petitioners admitted that they received the proceeds of such transactions for their own use, or that they should have reported these corporate transactions on their individual returns. Moreover, all of the so-called substituted items listed by the Respondent as being uncontested or stipulated were shown at the trial to have been reported on the returns of Gene Clark, Inc. [R. 460, 461].

In his brief, Respondent (Resp. Br. p. 54) accuses counsel for Petitioners of distorting the lower Court's findings by so-called self-serving computations. Petitioners consider this is a serious matter for it is tantamount to an accusation that counsel for Petitioners are attempting to deceive this Court by misstating the record. Specifically in answer to footnote 11 at page 54 of Respondent's Brief, the Tax Court did not leave out of its computation the deferred income item of \$5,080.40 for fiscal year 1948 in reconstructing total fiscal 1948 distributions. The \$5,080.40 item is part of the \$104,408.02 earnings and profits available for distribution [R. 122].

The Respondent states also that the \$5,080.40 was included in total distributions in Taxpayer's Exhibit F Summary, "not once but twice." This statement is likewise

erroneous. Exhibit F of Petitioners' Brief, page 9 of Appendix, sets forth a total of \$77,207.15, representing transactions which occurred in the calendar year 1948, as follows:

Substituted deposits	\$ 9,503.34
Unreported income in other banks accounts	39,300.87
Gain on sale of assets	2,245.09
Advance on Contract Sales	5,080.40

Other Items of Unreported Income—
Schedule 2 of Exhibit 3-C

January 9, 1948—Allen T. Mitchell & Son	\$ 2,294.50	
February 10, 1948—A & F Plumbing & Heating	2,223.76	
March 2, 1948—Valley Boulevard Plumbing & Electric Co.	12,000.00	
April 21, 1948—Ben Lang	1,558.44	
April 30, 1948—Ben Lang (contra item)	1,300.75	
February 12, 1948—Sale of Truck [Ex. Y]	1,700.00	21,077.45
Total		<hr/> \$77,207.15

Exhibit E of Petitioners' Brief, page 5 of Appendix, includes the amount of \$63,488.47. This amount represents items which the Revenue Agent determined in his report [Ex. 3-C] were not available for distribution in Gene Clark, Inc.'s fiscal year ending April 30, 1947, but were available for distribution in its fiscal year ending April 30, 1948. The Revenue Agent's Report, as has been stated many times throughout Petitioners' Brief, was the basis of the deficiency notice. This amount has, therefore, been treated exactly the same as the Respondent asserted it should be treated in his deficiency notice, *i.e.*, as an amount not being available for distribution in fiscal 1947, but therefore available in fiscal year 1948 of Gene Clark, Inc. The Tax Court without affirmative evidence, on the other hand, treated it as being available for distribution in fiscal 1947 and therefore eliminated these items in fiscal 1948 [R. 122].

Appellate Review of Findings of Tax Court.

Respondent states that “on factual issues, such as are presently presented, the Tax Court’s determination should not properly be disturbed on review unless clearly erroneous” [R. 34].

It is well settled that findings such as those that now confront us, *i.e.*, that all asserted available earnings and profits of a corporation were actually distributed to such corporation’s stockholders at particular times, are in the nature of ultimate findings of fact, and since such findings are but legal inferences from other facts, they are subject to review free of the restraint of the so-called “clearly erroneous” doctrine.

Curtis Company v. Commissioner (3d Cir., 1956),
232 F. 2d 167, 168;

Raymond Pearson Motor Company, et al. v. Commissioner (5th Cir., 1957), 246 F. 2d 509.

This Court in *Gillette’s Estate v. Commissioner* (9th Cir., 1950), 182 F. 2d 1010 at 1014 and 1015, stated:

“A finding is ‘clearly erroneous’ when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.

* * *

“* * * it is in no way derogatory to the Tax Court to say that United States Court of Appeals are as well equipped to draw inferences as is the Tax Court and for that reason the Tax Court decision calls for little more weight than its logic suggests.”

B. The Tax Court Erred in Finding and Concluding That the Commissioner Had Sustained His Burden of Proving Fraud.

The matter of fraud has been fully covered in Petitioners' Opening Brief (pp. 28-31, incl.).

The Respondent has merely restated the Tax Court's opinion. The Petitioners, therefore, do not feel that further elaboration in regard to this issue is warranted.

C. Section 275(c) Bars the Assessment and Collection of Any Deficiencies.

The Respondent agrees that he has the burden of proof to establish by affirmative evidence that at least \$2,282.63 (25% of the reported calendar year 1947 gross income of each of the Petitioners) was omitted from Petitioners' returns (Resp. Br. p. 65).

He specifies the following 1947 transactions as proving there was such an omission:

<u>Exhibit</u>	<u>Item</u>	<u>Amount</u>
U	Hamilton Homes	\$1,221.00
V	Hamilton Homes	2,170.00
W	Hamilton Homes	2,295.00
X	H. K. Niles	1,000.00
AA	Valley Cities Supply Company (endorsed by Koyl)	2,731.54
TOTAL		<u>\$9,417.54</u>

Exhibits U, V, W and X were so-called substituted deposits. They were deposited in Gene Clark, Inc.'s bank account and reported on its return [R. 458, 460, 461, 471]. If other items were substituted for these checks, there was absolutely no proof presented in the trial of

this case. The Commissioner cannot sustain his burden of proof by a mere arbitrary theory.

Exhibit AA is a check which was endorsed by Archie Koyl, indicating that he was the recipient of this check. This check, standing alone, is not evidence that Petitioners received the proceeds thereof.

Conclusion.

The determination of the Commissioner was incorrect. This was recognized by the lower Court during the trial of this case [R. 187]. Although the Petitioners proved the method used by the Commissioner to arrive at the deficiencies was arbitrary and produced erroneous results, the determinations of the Commissioner, based upon such method, were sustained.

The instant case is analogous to *Gasper v. Commissioner* (6th Cir., 1955), 225 F. 2d 284. Under similar circumstances to those now under consideration, the Court stated, at page 287:

“The Tax Court, therefore, held that while the method adopted by the Commissioner to determine deficiencies of petitioner is wrong and obviously leads to an incorrect conclusion, nevertheless, since the Commissioner had made such a determination—even though by such an erroneous method—the burden was upon the petitioner to show that the method used produced erroneous results. Although petitioner proved that, for the year 1945, the method produced erroneous results, and although the same method was used by the Commissioner for the other taxable year, and according to the Tax Court, was a wrong method and not calculated to produce correct results, the determinations of the Commissioner, based upon such a method, were sustained.

“The above conclusion of the Tax Court appears directly contrary to the holding of the Supreme Court in *Helvering v. Taylor*, 293 U. S. 507, 55 S. Ct. 287, 289, 79 L. Ed. 623.”

In summary, Respondent's Brief does nothing to strengthen the weaknesses of the Tax Court's opinion, which Petitioners have heretofore discussed in their Opening Brief. The conclusion of the Tax Court still remains erroneous and its decision should therefore, be reversed and judgment entered in favor of the Petitioners.

Dated: November 6, 1958.

Respectfully submitted,

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By THOMAS A. BAIRD,

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